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## **“Loans in Areas Having Special Flood Hazards: Interagency Questions and Answers Regarding Flood Insurance”**

OCC – Office of the Comptroller of the Currency  
Docket Number: OCC-2009-0014

Federal Reserve  
Docket Number: R-1311

Federal Deposit Insurance Corporation  
RIN Number: 3064-ZA00

Office of Thrift Supervision  
ID: OTS-2009-0005

National Credit Union Administration  
MSB Commends on Flood Insurance, Interagency Questions and Answers

The following comments are submitted for consideration by Marshall & Swift / Boekch LLC (MSB). MSB is the pioneer and national leader in providing property valuation solutions to the Insurance, Appraisal, Banking and Government industries. MSB's 77+ year history of collecting construction cost data, our breadth of markets served, and our lessons learned in these markets provides our organization a unique perspective in the history of valuation methodologies, appropriate valuation determinations / risk assessment and the challenges faced by the various industries.

We appreciate the opportunity to assist in the clarification and definition as requested by the Agencies. It is important to note that the following information is provide as it pertains to the specific questions asked and not the determination of policy or process requirements by FEMA, NFIP or other Agencies.

### **Question # 9 – What is the insurable value of a building?**

The “insurable value” or what is, according to Peter M. Wells in his book INSURING TO VALUE, the building’s “Insurance to Value” (ITV) amount for both a residential and/or non-residential building, is the cost to “reconstruct” that specific structure with “*Like, Kind and Quality*” materials, construction standards, design/layout and quality of workmanship at that location after damage, interruption or loss renders it no longer usable. The concept of insurable value assumes the worse case scenario so that industries like insurance develop premium algorithms reflective of the total cost to demolish and restore the structure or its “RECONSTRUCTION COST.”

There are many site-specific and process related costs that are experienced when rebuilding after a loss which are often being missed in the equation and definition as used by government and banking industries today. This is possibly why there is confusion and a need for clarification to these industries. It is also true that the majority of restoration work for total RECONSTRUCTION is performed predominantly by reconstruction experts and not typical home builders of tract assignments. Experts know they must retrofit an existing structure back to its original shape in the same place it existed, not start over with a clean design. Retrofitting is clearly different and more labor intensive requiring a higher skill set. And since the work condition is assumed to be more dangerous where total loss damage occurs, things like workers compensation rates are often times higher while productivity is less.

Estimating the proper Reconstruction Cost Value (RCV) as used in the insurance industry is the most accurate and effective means in underwriting the value of a structure. The value determined when using the reconstruction cost methodology includes the real world costs associated with rebuilding after a loss. Examples of these often overlooked costs are:

- Higher Labor, Mark-up and Contingency Costs: The required experience levels of the labor force, the complexity of reconstruction vs new construction projects and the physical conditions associated with rebuilding after a loss need to be factored in when developing an insurable value
- The Construction Process Change: The reconstruction process does not follow the same sequence of events as in the new construction process and therefore affects the dollar cost to accomplish these types of projects.
- Time Urgency Costs: After a loss, time is of the essence as additional costs associated with ALE (Additional Living Expenses) and BI (Business Interruption) can be significant following an interruption and often require additional consideration in developing insurable value. Pressure is on contractors to work as quickly as possible to alleviate these costs.
- Limited Site Mobility: there are several factors which are non-existent or of little consequence when building new, but need to be considered by the reconstruction contractor.
  - Protection of existing landscaping, vegetation or other site improvements and utilities.
  - Limited site access for equipment, materials and resources
  - Adjoining non-construction areas influence
- Dangerous or Hazardous Materials and Conditions: during the reconstruction process, contractors are faced with possible dangerous or hazardous materials such as asbestos, lead, mercury, etc. This may require professional inspection, testing and mediation costs to be incurred in reconstruction vs new construction
- Additional Soft Costs: These microcosm and highly susceptible costs show economic influences within geographic areas which can greatly influence total costs varying at the 5 digit zip code level.
  - Vacation areas with high density
  - Highly Desirable Areas
  - Remote Areas (mountain, island, etc.)
  - Regulatory issues such as licensing of contractors, rules regarding work hours, noise, dust etc.
  - Local Construction Code Compliance issues
  - Local Labor Practices

After decades of research and millions of reviewed valuations and claims, MSB developed the Reconstruction Cost Methodology whereby the physical structures ITV could be more appropriately determined in case of catastrophic loss or damage event by utilizing the above mentioned variables in cost.

Per FEMA guidelines “the insurable value of a building is the same as 100 percent replacement cost value of the insured building” which defines replacement cost as “the cost to replace property with the same kind of material and construction without deduction for depreciation”. This does NOT reflect a clear representation of cost to rebuild.

Often times in government and banking, the concepts and definitions can be clouded by the agency or organization mixing methodologies, definitions or purpose/need behind it. Originally the concepts around replacement cost were developed to understand the cost to build a structure “NEW” today in like, kind and quality model of an existing structure.

Simply put: what would it cost to build this type of property new today in this geo-specific area. This is NOT the same as reconstructing an existing property today in this geo-specific area.

MSB advises the Agencies to reconsider the use of replacement cost terminology and institute a reconstruction cost terminology in the definition. This more appropriately reflects the true costs associated with defining “Insurable Value”

MSB believes the definition of “Insurable Value” should not be mixed with definitions of other values, (the use of “Functional Building Cost Value” or “Demolition/Removal Cost Value”) as this is a business process or policy decision not a definition of insurable value of a structure. The choices to use the FBCV or DRCV should remain outside the scope of Insurable Value to avoid misunderstanding by consumers and industry alike.

### **Question # 10 – Are there alternative approaches to determining the insurable value of a building?**

Per FEMA guidelines referenced in Question #9 by the Agencies in this inquiry, the:

*insurable value of a building is the same as 100 percent replacement cost value of the insured building. FEMA’s Mandatory Purchase of Flood Insurance Guidelines defines replacement cost as “The cost to replace property with the same kind of material and construction without deduction for depreciation.”*

Therefore, although there are technically alternative methods of valuing the amount of insurance desired (ie: where the structures are not a concern, etc.), *there is only one method of determining actual insurable value that matters to an impacted property owner: full RCV.*

In our work, we have seen repeatedly how misunderstanding of the definition can cause a property owner to underinsure their property. It is critical that property owners are given the proper RCV insurable estimate, and then in cases related to commercial or farm buildings be given the option to adjust that value per the Agencies’ comments.

Only by knowing the true RCV can a property owner make an informed decision about coverage. *And, in particular, as suggested by the Agencies and FEMA, it is critical that residential property owners be made aware RCV and not be given an option for lesser coverage.*

This is a business process or policy determination which should not be mixed with the insurable value determination/definition. That is, for an agricultural building that would not be replaced, the insurable value is related to RCV; however, the *coverage amount* selected could be zero or demolition.

The question could read: “Are there acceptable alternative approaches to defining coverage amounts other than the definition of insurable value?” The answer to this question is “YES”.

The use of: “functional building cost value” or “demolition or removal cost value” are both alternative approaches of defining value which may be appropriate to the agencies and the business processes surrounding commercial or agricultural buildings. But the term “Insurable Value” should be maintained as related to the RCV and as distinct from the policy coverage limit or coverage amount desired/selected.

MSB does suggest that an insured should be allowed to take a different method of valuation provided the risks associated with these valuation methods are clearly communicated, documented and known in these situations.

### **Conclusion**

MSB appreciates the opportunity to comment on these matters and believes there is room for improvement in defining cross industry standards and definitions. The banking and insurance industry, based on need, do not use the same term definitions as the business needs for each industry are different and it motivates their interpretations.

- The banking industry being concerned with the Loan Value, Market Value and Appraised Values is not looking at the true determinations of Insurable value. This lack of familiarity and need for true insurable value causes problems for consumers and policy makers alike.

- The insurance industry being concerned with insurable value operates on a standard definition of reconstruction cost methodologies but doesn't operate in the Market Value, Appraised Value or Loan Value arena.

MSB suggests that there is only one definition for Insurable Value known in the industry as "Insurance-to-Value" (ITV).

Definition:

**Insurable Value / Insurance-To-Value (ITV) is defined as:**

The site-specific cost to reconstruct a property with like kind and quality material, construction standards, design/layout and quality of workmanship at the time a loss occurs.

MSB would be happy to provide additional supporting information or documentation upon request.

These comments are respectfully submitted on behalf of MSB by:

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If you should have any questions or comments, please do not hesitate to contact us.