INFLATION AND PROPERTY VALUES: 4 Steps to Fortify Your Business

By Stephen Hicks

Most lumber business owners already understand the many ways that inflation has impacted their companies. In their world, it is no secret that prices for building materials and labor have risen on average by about 36% over the last three years alone, according to the U.S. Bureau of Labor Statistics Producer Price Index (PPI).

But these price increases don't just affect the cost of inventory and the product prices that companies charge their customers. They also impact the amount lumber operators will have to pay to rebuild their businesses in the event of wind, hail, or fire damage. That's why it's imperative for business owners to update their property values and avoid a potential case of sticker shock after filing a claim.

What's Driving the Increases?

While we often see inflation expressed as a nationwide percentage, specific inflationary pressures vary widely among sectors. The cost of reconstruction is a prime example.

Those costs vary depending on the type of structure being rebuilt. For example, costs on new schools have risen about 30% over the past three years, but costs on new warehouses are up above 45%, according to the PPI.

Underlying these cost increases are both labor and building materials. While softwood prices have returned to earth, concrete prices are up 25% over the past three years, gypsum wallboard is up 45%, and structural steel is up almost 55%. Increases may be leveling off from recent historic highs, but overall costs remain greatly elevated from pre-pandemic levels.

All of this directly impacts many aspects of a lumber company's property insurance coverage. We have seen property valued at $1 million three years ago valued at $3 to $4 million today. This valuation includes factors like rising replacement costs for property and inventory, along with increasing business interruption expenses.

Adding to the complexity of the problem is the increased risk of weather-related property damage. In the first half of 2023 alone, severe convective storms created nearly $37 billion in global losses—an all-time record, according to Aon's Global Catastrophe Recap. Ninety-five percent of those losses occurred in the U.S.

How to Protect your Business

This combination of market and weather forces makes it imperative for lumber operators to obtain the most accurate and current valuations of their inventory and businesses.

To ensure your business is adequately protected, consider these four best practices:

1. **Be proactive:** Don't wait until your carrier calls you to start the discussion. Instead, reach out to your agent or broker. They will rely on you to be the expert on your business. Provide them with details about your property and your inventory, including any recent changes such as inventory surges, new buildings, or significant capital improvements. Then, ask your insurance advisor to give you a Statement of Values that you can sign off on.

2. Review your inventory limits: Make sure your policy covers the cost of inventory replacement. Pay particular attention to commodities you store that have undergone the greatest amount of price volatility.

3. Consider your building contents and equipment costs. While inflation has been the biggest driver of property values over the past three years, ongoing supply chain complexities are another complicating factor. This impacts rebuilding costs and lengthens the potential restoration period for your business. For example, we have seen equipment that had a four-month lead time pre-pandemic have a one-year lead time now due to labor fluctuations, production impacts, and delivery bottlenecks.

As you review your policies with your carrier or broker, be sure that your equipment limits will still cover you in the event of a loss. Also, evaluate your business interruption coverage and ensure it reflects today's realities.

4. Reduce your risk: The basic equation insurers use to develop your premium is rate multiplied by exposure. As values (exposures) increase, premiums increase commensurately. The more steps you can take to reduce your risk, the more likely you will be to mitigate rate increases, which are happening across the industry as well. Working alarms and sprinkler systems, updated roofs, new wiring, and other infrastructure improvements are proven risk mitigation steps.

Another wise approach is to explore the potential benefits of receiving FORTIFIED™ Commercial designation for some or all of your buildings. This program, conducted by the Insurance Institute for Business and Home Safety, offers a set of requirements designed to strengthen new and existing commercial buildings against severe weather.

While inflation is an unfortunate new reality, it shouldn't create vulnerabilities for your business. By collaborating with your insurer and right-sizing your property values, you will gain peace of mind knowing that you are covered in the event of a loss. LC

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