

In this *Market Insights* bulletin, we consider a hot topic affecting all Canadians — inflation. We will look at how inflation relates to the increase in insurable values and how it can also influence the performance of the insurance industry.

### ADAPTING TO INFLATIONARY TIMES

Throughout 2022, rising inflation has been top of mind globally for many. In Canada, consumer inflation rose to a 40-year high, reaching a peak of 8.1% in the summer, according to Statistics Canada. And, as far as we can tell, it shows no sign of abating in the short term.

**How does this impact insurance?** Canada's inflation is measured and reported by Statistics Canada as a percentage change, and the effects on insurance can be closely linked. In the current insurance market, inflation presents itself in:



Rising construction costs - which then cause replacement cost valuations to increase.



Rising property maintenance and repair expenses - if there is a claim, it simply costs more to remedy the damage.

### RISING CONSTRUCTION COSTS

Completing construction projects on time and on budget has been more challenging with contractor shortages and material delays this past year. We have seen many components of construction projects affected by inflation such as:

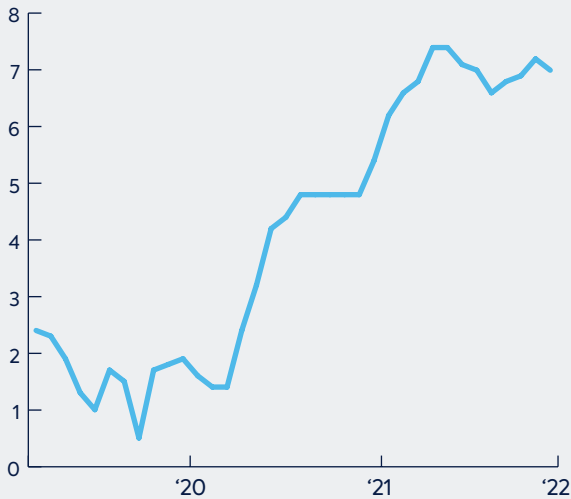
- **Building materials** — cabinets, flooring, lumber, drywall, and paint material have seen prices increase between 35 to 50%.
- **General expenses** — fuel, vehicle maintenance, rents, utilities, site protection, packaging and safety products have been volatile, with expenses rising approximately 20%.
- **Wait times for materials** — appliances, flooring, custom and special-order items such as doors, windows, bathroom showers, tubs and vanities have been highly affected by supply chain challenges, with lead times going from six weeks to six or eight months.
- **Labour shortages** — A lack of skilled workers has caused a delay in getting work started, lengthening the average time for construction projects.

### RISING CLAIMS COSTS

For insurers, one of the top impacts on performance is the cost of future claims on current policies. Claims are based on costs at the time of a loss, and costs tend to increase during inflationary times, though not directly in line with the Consumer Price Index. For properties, the values of the insured property are based on the cost to repair or replace the item at the time of loss in almost all cases. Very few contracts provide a pre-specified fixed value. Therefore, as inflation increases the value of the property, the average cost of claims increases. This means it will cost more than expected to settle claims.

## Canadian Price Index - Shelter

Jan 2020–Dec 2022 (12 month % change)



Source: Statistics Canada

## Construction Cost Impacts

Summary of construction cost increases



**35–50%**

Building material price increases



**20%**

General expense increases



**42–180 days**

Average wait times for materials

## SIGNIFICANCE OF ACCURATE VALUATIONS

Since insurers provide replacement cost coverage, inflationary times require a re-evaluation of risks to ensure clients are adequately insured. Considering replacement costs may have increased due to inflation, clients should check that their insurance coverage reflects the correct valuation.

### Benefits of annual appraisals to property managers, boards, councils and individual owners:

- Providing the property with a third-party expert assessment.
- Offering full compliance with legislation that requires stratas and condominium projects be insured to full replacement cost.
- Eliminating the possibility of any shortfall in limits and ensures that an insurance policy adequately protects owners in the event of a loss.

Working with a professional appraisal firm provides a degree of certainty found during a time when there are significant fluctuations in the values of labour and material costs. This year a typical appraisal has jumped by double digits due to the true cost of reconstruction.

## RESILIENCE IN DISRUPTIVE AND VOLATILE TIMES

The insurance industry has experienced a market transition, and before Hurricane Ian in 2022 (considered one of the three costliest weather disasters on record) had been showing signs of stabilization. However, economic uncertainty, rising inflation, supply chain disruptions, catastrophic weather and global economic shifts mean that careful underwriting conditions are expected to persist over this coming year.

**BFL CANADA** commits to being at the forefront of the dialogue, ensuring we monitor this ever-evolving world and provide the best advice to the industry and our clients.