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Lost on Loss-of-Value?

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To the adjuster handling the claim, it seemed like a problem requiring the wisdom of Solomon. The insured insisted his A. Y. Jackson landscape painting would never be the same after sustaining a large, jagged rip during a move from Montreal. Insured at \$200,000, he insisted the painting was a total loss. The dealer who sold him the painting agreed and submitted a single page appraisal advising that the painting was worthless in its current state.

The art restorer hired by the moving company to survey the damage had a conflicting opinion. She insisted the painting could be restored with only a marginal loss-of-value. Her associate, a private fine art dealer with experience in the Jackson market, provided an appraisal report advising a 10% loss-of-value.

In an effort to get a truly independent opinion on the loss, the adjuster hired a well-known fine art auctioneer to provide an appraisal. The auctioneer's report suggested that even in perfect condition, the painting was worth only \$125,000 -- \$75,000 less than the insured value. She indicated that after repair the painting would suffer a 20% loss of value -- bringing its value down to a level of \$100,000. The auctioneer provided no evidence for this assessment, referring only to her 15 years of experience in the art business. The adjuster knew that the headaches on the file were just beginning. He began to imagine that he was the real victim of the loss.

Although the above scenario is a pastiche of several different incidents, it conveys the very real problems that plague fine art and antique property claims involving loss-of-value. Every "expert" consulted has a divergent opinion and few are able to back up their assessments with evidence. Indeed, the whole loss-of-value concept begins to look like little more than guesswork.

With lower end art and antique objects, a wrong "guess" by an appraiser is not particularly damaging to anyone. On the other hand, if the item involved is of high value -- such as the A.Y. Jackson oil painting insured for \$200,000 -- the financial impact can be considerable. The difference between a loss-of-value estimate of 10% and one of 50% is \$80,000 -- no small amount by anyone's account. Clearly, as the replacement value of an art or antique object rises, the stakes increase in this very confusing type of loss situation.

Although statistics on the economic impact of "wrong guesses" related to loss-of-value appraisals are scarce, I suspect they are considerable. In my appraisal practice I run into many situations where high value art and antiques objects are insured on the basis of extremely suspect valuations. When the general lack of understanding of the loss-of-value concept is thrown into the equation, the potential for damage to the insurance industry grows dramatically.

Confusion surrounding the loss-of-value concept is plentiful. Most people who value fine art and antiques do not have recognized training in valuation principles. As a consequence, they do not

understand how to utilize loss-of-value procedures in an insurance valuation. Few appraisers grasp that it is essential for a loss-of-value estimate to be based upon market evidence and logic. Guesses, gut reactions and tired, unconfirmed formulae should not be used in insurance settlement situations.

In addition, those active in the antiques and art trade possess specialized knowledge not known to most outsiders and often browbeat the uninitiated when it comes to loss-of-value. Adjusters unfamiliar with collectible objects may be intimidated by so-called experts, or they may not be able to identify when they are being misled in an appraisal report. They sometimes end up suppressing their normal healthy skepticism. To top it off, many who provide appraisals also have pecuniary interests in the type of property they value; they may not be providing unbiased opinions.

The best way to combat these factors -- and to understand how loss-of-value works in a fine art or antique property appraisal -- is to know what the concept is *and* what it is not. Put most succinctly, loss-of-value is the reduction of worth resulting from damage and any subsequent restoration. This definition has been recognized by fine arts insurance specialists in the United States. In the March, 1990 edition of *International Broker*, Huntington Block opined that "in a fine arts claim, there are two elements in a damage related loss: restoration and depreciation. If a work is damaged, the insurer pays restoration experts to bring it back to pristine condition. But, while the painting may look very good, it will probably have lost about 30% of its value. Although I disagree with Block's generalization about the quantum of loss-of-value, his basic understanding of the concept is absolutely correct.

Equally important to the loss-of-value concept is what it is not. Loss-of-value *is not* the difference in worth between a damaged, unrestored object and a similar property in perfect condition. This type of depreciation -- the difference between salvage value and replacement value -- is just part of the picture. In most cases, an appraiser can only provide a comprehensive loss-of-value estimate after restoration.

A case study illustrates the considerable difference between loss-of-value and depreciation due to damage. The replacement cost of a rare 17th century Japanese *Kakiemon* porcelain vase in relatively pristine condition is approximately \$50,000 in today's international auction market. If the same vase was damaged and expertly restored, its might cost \$20,000 to replace. Broken and unrestored, however, the salvage value could be as low as \$10,000 -- a full \$10,000 less than a properly restored example. On the basis of this information, the loss-of-value to the property after restoration would be \$30,000. It would not be correct to assess a loss-of-value of \$40,000 in this instance -- the difference between salvage value and replacement value.

This example provides a thumbnail sketch of how a professional appraiser tackles the problem of loss-of-value using the market comparison approach. Ideally, the appraiser must: a) estimate the replacement cost of the undamaged subject property by comparing it with similar objects sold in the most relevant marketplace; b) identify sales of comparable objects in a restored state; and c) calculate the loss-of-value by subtracting the second value conclusion from the first. The result can be either a dollar value or a percentage of value.

In reality however, the appraiser often finds it difficult to identify sales of comparable objects in both a pristine and a restored state. As a result, round-about methods may have to be utilized. For example, in one file I handled several years ago concerning an enormous contemporary mixed media painting by an important Canadian artist, there were no sales of comparable restored works. I had to look to a market that demonstrated a similar attitude to repairs, settling on high value contemporary prints by important American artists. Through the use of a number of matched pairs (i.e. pairs of identical prints from the same edition in both pristine and a less than perfect state), I was able to establish a relatively consistent pattern of value and condition. The pattern was then applied to the painting in order to estimate loss-of-value. This use of parallels is invaluable in the loss-of value approach.

Two additional factors are particularly important in estimating loss-of-value and should be considered by the adjuster reading an appraisal report. First, damage and restoration are not viewed in the same way for every property type. This is demonstrated with two very different properties -- contemporary hand-blown art glass sculpture and Old Master paintings. With high end art glass sculpture, even the most minimal damage and restoration can result in a 100% loss-of value. This is the case because the marketplace demands glass sculpture in absolutely perfect condition. The slightest flaw is not acceptable to potential buyers. In contrast, the Old Masters market has a relatively high tolerance for damage and repair. Indeed, there are very few four hundred year old paintings available for sale that have not been subject to some restoration. As a result, old damage and restoration do not have the same drastic effect on value that is evidenced in the contemporary art glass market. It is essential that the appraiser consider the tolerance for repairs demonstrated in the relevant market.

A second factor that merits consideration by both the appraiser and the adjuster is inherent vice. Any loss-of-value appraisals involving antique objects (i.e. over 100 years old), and particularly fragile objects should address this issue. Old repairs and damage can result in a highly unstable object that is ripe for further deterioration. In the case of a broken and newly repaired 18th century Meissen porcelain figurine with a very old crack, the appraiser (with the assistance of the restorer) should identify the relationship of the new damage and the old. If they are in any way connected, the old crack may well have been a crucial factor contributing to the new damage. Failing to identify that the object was damaged prior to the loss will result in an excessive and unwarranted loss-of-value estimate.

In order to consider all the factors necessary to write a supportable loss-of-value report, the appraiser has certain requirements. Obviously, access to the damaged property after it has been restored is essential. Without assessing the quality of the repairs, it is almost impossible to quantify the loss. Additionally, it is absolutely essential that the appraiser be provided with all relevant documentation. This includes, but is not limited to old appraisals, original bills of sale, restoration reports, etc. This type of documentation helps to establish a context of value, identity, and condition. Finally, the appraiser requires a reasonable amount of time to complete the research, analysis and valuation steps involved in a loss-of-value appraisal. It is unreasonable to expect the appraiser to pull everything together in a few short days when outside research and consultations are required.

As this article demonstrates, a loss-of-value estimate is one of the most complex types of personal property appraisal. Unless the damaged property has an agreed value, the appraiser has to provide evidence for the extent of the loss *and* a replacement value estimate. This entails more professional time and as a consequence, higher fees to the adjuster. As such, it makes little sense to commission this type of appraisal for lower value items. The costs involved will inevitably outweigh the benefits. For art and antique objects of high value, however, this type of appraisal is ideal. At their best, professional loss-of-value appraisals inject a healthy dose of evidence and reality into an arena dominated by unsubstantiated guesswork. Although these appraisals will never entirely eliminate the requirement for the adjuster to exercise Solomon-like wisdom in an art or antique property loss, they will help to minimize unrealistic claims and make those difficult files a lot more bearable.

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