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Building the Perfect Asset Portfolio

Optimizing Total Cost of Ownership and Risk for Best Outcomes

By James Gilles

When it comes to discussions around risk management approaches, risk advisors traditionally lean on the concept of “Total Cost of Risk” to help inform their clients on what they need to consider when selecting/setting up their risk management program. While Total Cost of Risk is a vital concept for real estate owners and developers, a more comprehensive method for measuring financial and risk efficiency is one that takes a whole-life cycle view of the asset “Total Cost of Ownership” where Total Cost of Risk is a component part of this offers a more holistic view. The intention of this article is to breakdown the differences between the two concepts while highlighting the integrated approach where optimization occurs within both key measures of capex efficiency.

TOTAL COST OF RISK (TCOR)

TCOR represents the sum of all expenses related to managing and transferring risk. With respect to risk solutions, it encompasses both direct and indirect costs associated with obtaining and maintaining coverage, handling losses, and implementing risk management measures. The expense metrics that make up TCOR include:

1. Insurance Premiums: Premiums and performance security are one of the largest components of TCOR. These are the direct payments made to insurers for transferring specific risks, like property damage, liability claims, and more. When calculating premium real estate owners and developers need to consider premiums in both the construction phase and the operations phase when calculating TCOR.

2. Retained Losses and Deductibles: Many insurance policies require the policyholder to bear some initial costs, known as deductibles. Retained losses cover any uninsured portions of claims, which can be significant, particularly in high-frequency, low-severity claim environments.

3. Risk Management and Loss Control: These are the costs associated with running a risk management and risk control department. In addition to these costs, cost related to preventative measures, such as installing fire safety equipment, security systems, and IoT devices, can reduce claims but also add to the overall TCOR.

4. Claims Administration: Handling claims, whether in-house or outsourced, represents another component. Effective claims management can minimize losses and expedite settlements, ultimately helping to contain the total cost of risk. By understanding the expense levers under TCOR, real estate owner and developers can determine the most effective risk control, risk transfer and risk retention strategies thus allowing for informed decisions about the types and levels of coverage required.

TOTAL COST OF OWNERSHIP (TCOO)

While TCOR focuses on expenses related to managing and transferring risk for the entire organization, TCOO aims to capture the entire financial costs over the life of your asset (or in aggregate – your asset portfolio). Key components of TCOO include:

1. Acquisition Costs: This includes the purchase price, transaction fees, and financing expenses.

2. Design and Construction Costs: Costs associated with any construction associated with the asset – greenfield, brownfield, and retrofits.

3. Operational & Maintenance Costs: Operational costs often consume a significant portion of a property's revenue stream. This includes expenses like utilities, maintenance, cleaning, property management, and insurance. Maintenance costs are another critical factor. Regular, preventative maintenance is less expensive than emergency repairs or major overhauls down the line.

4. Sustainability Investments: Sustainability is no longer an optional feature. Commercial real estate owners need to consider the financial implications of retrofitting their buildings to meet these standards. While the upfront costs for energy-efficient windows, solar panels, green roofs, and advanced insulation may seem high, the long-term savings in energy consumption, reduced emissions, and enhanced tenant satisfaction can more than offset these investments. Moreover, buildings with strong sustainability credentials often command higher rents and better tenant retention rates. Tenants are increasingly seeking spaces that align with their own sustainability goals, and buildings with certifications like LEED (Leadership in Energy and Environmental Design) or BOMA BEST (Building Environmental Standards) tend to attract a higher caliber of tenants willing to pay premium rents.

5. Regulatory Compliance and Futureproofing: The cost of staying compliant with government regulations, such as fire safety codes, accessibility standards, and environmental regulations, is another key aspect of TCOO. Compliance costs can be significant, especially when buildings are subject to new regulations that require structural changes, upgrades, or additional safety measures. Looking ahead, future-proofing commercial buildings is crucial. Climate change is leading to more frequent extreme weather events, and insurers are raising premiums or declining coverage for properties that are not adequately protected against these risks. Investing in climate resilience—whether through floodproofing, fire-resistant materials, or wind-resistant construction—will mitigate future repair and insurance costs while preserving the long-term value of the property.

6. Technology Integration: The integration of smart technology into buildings, during the construction and operations phase, is rapidly becoming a key factor in controlling TCOO. Smart construction and building systems monitor workmanship, safety, water damage, structural risk, energy use, automate lighting and HVAC, and improve security, all of which can reduce construction and operating costs. Property ownership and development is becoming increasingly complex. The 'good deal' based solely on acquisition and

construction/financing costs, could prove detrimental to an organization's long-term profitability. Owners and developers who take on a comprehensive approach to understanding TCOO during the entire financial lifecycle of an asset/project will be better positioned to maximize profitability and protect the long-term value of the asset.

"A BALANCED APPROACH"

For real estate owners and developers, balancing TCOR and TCOO is a strategic approach that aligns financial stability with asset resilience. Focusing solely on TCOO, one might overlook potential risks leading to unexpected losses. Ignoring TCOR, could result in unanticipated costs (deductibles obligations, uninsured losses/increased premiums) that affect long-term asset/project profitability and sustainability under TCOO. For example, an asset or project with better building materials with a focus on preventative risk management will lower TCOR and TCOO over time – Better risk profile thus leading to fewer claims/better insurance terms and conditions + Asset Value Protection & Sustainability long-term = "A Balanced Approach" A state of the art fire suppression system may increase initial ownership costs, but it will also lead to lower insurance premiums, risk mitigation and reduction in claims over the lifecycle of the asset. This balance ultimately involves the understanding that investment in risk mitigation can often drive down ownership costs, just as prudent asset management can reduce expenses.

CONCLUSION

While distinct, both concepts are interdependent and essential for informed decision-making. By considering TCOR and TCOO together, real estate owners and developers can proactively adjust insurance acquisition and maintenance strategies based on the asset's lifecycle and risk exposure, supporting a more resilient and financially sustainable ownership experience. Our Risk Advisors at PLATFORM Insurance would be happy to help you find "The Balanced Approach" within your construction and operational risk management programs. Optimized TCOO and TCOR will result in sustainable productivity and profit for your asset portfolio.

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