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Purchasing Insurance to Protect Against Casualty Losses

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If you can purchase fire Insurance it may cover wind in some areas. The insurance application requires an inventory and valuation of your timber. You have to make an insurance coverage request. Plus you have to submit a loss history and management plan certification. Finally, the application has to include available water sources and list of fire equipment and teams available.

At least one company offers mostly comprehensive cover for a numbers of catastrophes. Insured perils covered are the following: fire, lightning, explosion, wind, flood, ice and theft. While not mentioned specifically, coverage includes damage from tornados and hurricanes.

The qualifications are that the standing timber to be covered under this program must be under an active management plan as prescribed by a forest products company, a consultant forester, state forestry agency, or similar concern. The management plan must include the most recent timber cruise. The majority of the timber stand should be composed of southern yellow pine but hardwood stands can be covered by the policy. Firebreaks must be established and maintained.

The premium is based on the timber's value. For trees that have a merchantable value, the management plan or forester must determine the current value to be insured. Any payments for covered losses will be made based on the predetermined values in accordance with the provisions of the policy or the actual stumpage value, whichever is less.

For non-merchantable trees, the valuation is based on the actual cost of site preparation, planting, and maintenance costs plus seven percent interest compounded annually. Currently, rates vary from $0.65 to $1.25 per $100 of timber value.

There are some advantages to having this type of insurance. The availability of insurance allows the transfer of some of the risks associated with timberland ownership. Also, it makes leveraging of your timber asset easier since the timber's value is insured and it may allow you to make additional land purchases by borrowing against the timber values. Finally, the premiums paid for this insurance coverage may be deductible for tax purposes.

In a 2011 personal conversation with Dr. Debbie Gaddis, retired Extension Forestry Professor from Mississippi State University, she states "…that most people think that a casualty loss will not occur on their property so they don't bother to even think about the casualty loss deduction. You only receive the benefit of the loss deduction times the marginal tax rate. If you are in the 25 percent tax bracket the most you will save in taxes is the deduction times 25 percent. The casualty loss deduction, even if you have enough Basis to fully deduct your loss, is only going to allow you to recover a small portion of you loss. I have heard that people say the cost is far greater than it should be."

In a 2011 personal conversation with Dr. William Hoover, Professor of Natural Resource Social Science at Purdue University, he states that "…insurance is generally not a beneficial thing for a timber owner. There is not a large market for timber insurance, and the failed attempts to establish a market indicates the timber owners are not very interested in it. Usually the only circumstances when insurance, if available, makes sense are short periods during which the owner's risk tolerance is very low. This might be when the timber is playing a critical role in the financial needs of the owner, but the don't want to convert it to cash immediately. The cost for carrying insurance for a year or two might make financial sense if the cost of a loss is greater than the cost of the insurance. Many timber owners increase their risk tolerance for the timber because they know that the underlying land is also an investment almost always subject only to market risk, not physical risk. In the context of estate planning, life insurance can be used as a form of "timber insurance. The life insurance payout would be available to meet specified needs of the estate if something negative happened to the timber. If the timber pays out as expected, then the estate benefits from both."

“Any discussion of timber insurance should be in the context of reducing the owner’s level of risk. Owners who manage their investment portfolios using modern portfolio theory would factor in the physical and market risk of timber investments, timber and land desperately, and balance this with other investment options that provide the desired combination of risk and return. I’ve thought for a long time that the potential for long-term timber leases should be evaluated. Leases that guarantee the lessor a minimum royalty would provide a bottom to the level of return and thereby reduce the risk. The restructuring of the forest products industry changes the potential benefits to lessees, but I’ve never seen articles providing a reevaluation of this option for providing a secure timber supply.”

Have Questions? Contact Ben Jackson at bjack@uga.edu or 706-542-9051