



By  
Scott Spencer

As homeowners across the country watch the values of their homes plummet, they may start to think that their insurance premiums should follow suit. Many people think it's simple logic: Reduced market value equals reduced insurance premiums.

But many don't know the difference between market value and replacement value or understand that they don't often follow the same trend. In fact, even as home values continue their steep decline, the cost to rebuild

starts; housing shortages; and location. On the other hand, replacement cost variables can include material costs; fuel and energy costs; the cost and availability of skilled labor; and changing construction codes and standards.

When comparing the two, it's important to note that market value variables are mostly forward-looking perspectives with the impact yet to be fully incurred or determined. In contrast, the replacement cost variables exemplify costs that are impacting the housing market almost immediately.

Key factors that have contributed to rising construction costs during 2008 include:

- Fluctuating energy costs over the past year;
- Rise in the cost of skilled labor;
- Increased overseas demand for raw materials and building products;
- Varying profit margins from general contractors and their subcontractors; and
- Rise in framing lumber prices and wallboard.

Calculating replacement cost is not based solely on builders' costs, but also on many hidden costs that impact the industry.

Other factors: In a global market, the U.S. dollar is weak. Also, it's harder for construction companies to get loans. Many builders are going out of business, so there is less competition and a lesser need to compete on prices. Recent natural disasters, such as hurricanes along coastal regions, floods in the Midwest and wildfires out West, have contributed to shortages in materials and made it more risky to underwrite homes. The trend to build homes with environmentally-friendly materials, low-impact processes and ultra-efficient heating and cooling technology has added to the cost of building and repairing homes.

Insurance to value is important because it allows homeowners customers to have adequate limits to rebuild their homes, and allows carriers to collect adequate premiums and have adequate reserves to pay claims. That's why it's important to have certified home appraisers. **BR**

# Insurance to Value

As housing prices plummet, the cost to rebuild a home is on the rise.

a home continues to rise.

It's now more important than ever to remind homeowners that their insurance premiums are not based on the current resale value of their homes, but on the cost to replace them.

Residential construction is a worldwide industry impacted not only by the cost of materials, but also the cost of new technology, new building codes and regulations, labor and materials. Home construction costs rose sharply after Hurricane Katrina in 2005, as the demand for building materials, labor and energy outpaced the supply.

Prices continue to rise, according to recent statistics. Reed Construction Data estimates an increase of 4.2% on construction costs from 2007 to 2008, up from the 2.8% estimate from 2006 to 2007 for the same period. Marshall & Swift/Boeckh estimates a 1% to 2% increase on overall construction over the same time period, with higher increases in many metropolitan areas.

Several variables can contribute to the rise and fall of home prices, including: implications of the subprime lending crisis; foreclosure rates; new housing

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