

Risk Bulletin

The Difference Between Property Values and Rebuilding Costs

The commercial real estate market experiences upturns and downturns more frequently than other sectors. This market volatility can trigger questions about the difference between market value and insurance reconstruction costs. In this article, Allianz Global Corporate & Specialty (AGCS) provides insights for policyholders to understand the factors that drive the reconstruction costs to repair or replace damaged property, and how those factors differ from both the market value of the property and the cost associated with brand new construction.

Real Estate Market Value

Market value is the estimated price for which a property could be sold on the open market. It can depend on several factors such as location, building age and condition, accessibility, and availability of similar properties in the area.

Insurance Reconstruction Cost

Reconstruction cost is the cost to build an exact duplicate of a building using like kind and quality materials, construction standards, design, and quality of workmanship at the current prices. Allianz Global Corporate and Specialty uses reconstruction costs in the property underwriting to develop an insurance-to-value estimate. This valuation method allows for more



accurate policy limits, thus reducing the likelihood of underinsurance.

Replacement Cost versus Reconstruction Cost

While similar in concept, replacement cost is not synonymous with reconstruction cost. Replacement cost is the cost to construct or replace an entire building with equal quality and construction. Unlike reconstruction cost, replacement cost is based on new construction, which typically is a well in advance, planned, start-to-finish project with time to consider options and make changes. There are many additional site-specific and process-related costs that are experienced when rebuilding after a loss which are typically included in reconstruction cost but not in

replacement costs such as existing site improvements, demolition, debris removal, fees, or construction sequence changes.

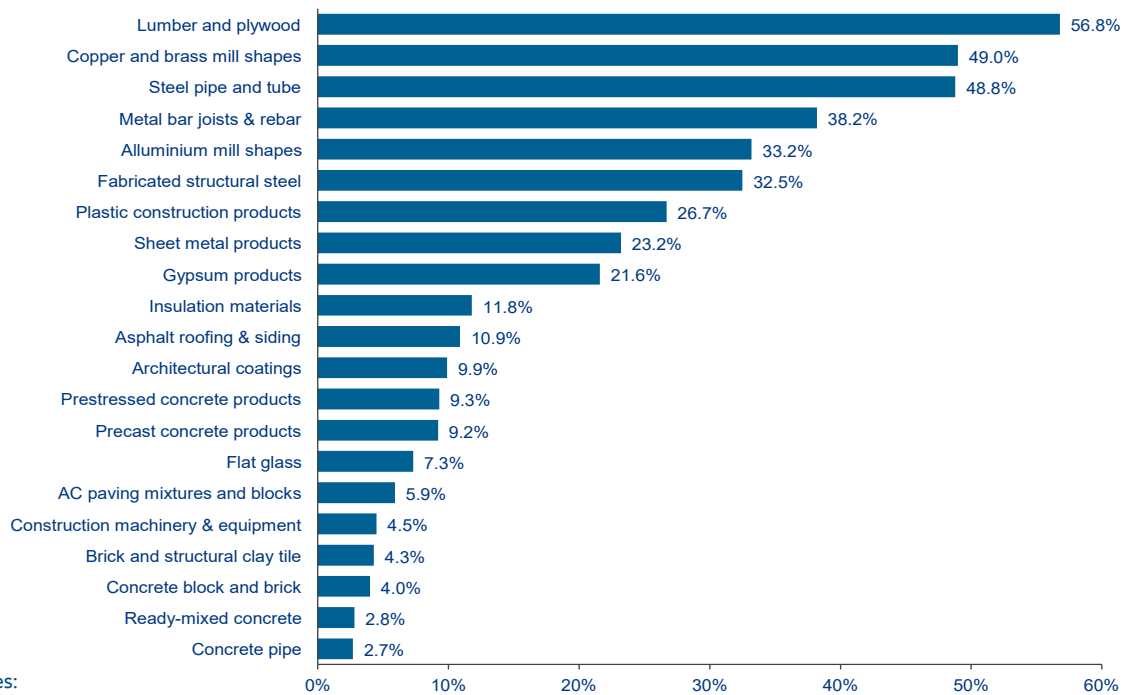
Factors Which Drive Insurance Reconstruction Costs Labor and Materials

According to data reported by CoreLogic* and Cumming**, firms specializing in building valuations for insurance purposes, costs of labor and construction materials have consistently trended upward since 2020, due to labor shortages, global supply chain constraints, and the general inflationary economic environment. Costs for some products in particular, such as lumber and steel piping, have increased dramatically as shown in the following graph.

* CoreLogic "Commercial Insurance Bulletins": [Insurance Bulletins - CoreLogic®](#)

** Cumming, "Domestic Material Price Trends." Q3, 2021
- [Domestic Material Price Trends | Cumming Insights](#)
- [Construction Market Analysis \(ccorpinsights.com\)](#)

Construction Materials Price Movement - Last 12 Months



Building Codes

Most jurisdictions require buildings to meet current codes during reconstruction. This can include addition of fire protection sprinklers, Americans with Disabilities Act upgrades, and improved building materials to meet newer wind or seismic designs. Some jurisdictions also require increased energy efficiency and inclusion of green technologies for reconstruction. Costs associated with such upgrades are not factors within the reconstruction cost valuation, which contemplates repairing or rebuilding with like kind and quality and does not include improvements to the building. Separate coverage for the cost of building code upgrades can be provided on the policy.

Construction Sequence Changes

In rebuilding an existing structure, the normal construction sequence may need to be changed. This can alter the order of operations, materials procurement, and require

more planning, leading to increased costs. Reusable components need to be salvaged, shored, braced, stored, and protected until such time as they are needed.

Restoration/Repair Contractors

Contractors involved with reconstruction may be more specialized than those involved in new construction. The labor rate for these contractors is often higher.

Site Accessibility

Numerous site factors which are not present during initial construction often impact reconstruction costs. These factors include existing underground and overhead utilities, neighboring structures, landscaping, and other site improvements.

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