



## Understanding home replacement cost

Our clients often ask us to explain the difference between the replacement cost and the market value of a home.

The answer is often much different than people think.

Market value can be defined in part as the most probable price that a property should bring in a competitive and open market under all conditions requisite to a fair sale. Replacement cost, otherwise referred to as reconstruction cost, represents an estimate to rebuild your home today, from the ground up, using like kind and quality materials. This includes demolition, debris removal, foundations and a general contractor's profit and overhead commensurate for the project. The cost also includes architectural and engineering fees, plans, permits and building code updates.

Replacement cost changes over time and should be monitored regularly. As the home is improved or upgraded, replacement costs are impacted. It is important to keep your agent up to date when you make any modifications. Labor and material costs change at different rates depending on location and other factors. It is important to remain sensitive to these changes so that coverage can be adjusted accordingly.

Below are some factors influencing replacement costs.

### Location

Have you ever heard the saying that the three most important factors in real estate are location, location, location? This is because it is often the single biggest factor driving the market value of a home. Location is similarly important when considering replacement cost of

your home. It is not uncommon for contractors to charge more when working in an affluent area. This might be due to extra time involved for plan approvals, environmental impact studies, such as in coastal areas, or even restrictions on which contractors are approved to work in a specific area. With less competition in a specific area, contractors can charge more. This often results in higher percentages for profit and overhead.

### Like kind and quality

It is possible that a typical buyer in a real estate transaction would not pay more for a historically significant and costly carved marble fireplace surround imported from France. Nor would he or she pay more for a Ludowici clay tile roof versus a more common brand of similar style and function. However, in the above definition of replacement cost, like kind and quality are important factors. If these items were part of a covered loss, they would be replaced with a fireplace mantel of similar or equal historic significance, and the roof would be replaced with a new Ludowici clay tile roof.

### Foundation

Why should the foundation be included? Masonry products like brick and concrete do not burn like most materials found within a home. However, that does not mean it is fireproof. For example, concrete is made up of numerous components, such as water and aggregate, that can be damaged from rapidly changing, high temperatures, leaving the structural integrity of the concrete compromised.

## Demolition and debris removal

Since our estimates are created based on a total loss scenario, demolition and debris removal costs are included. These costs can vary significantly depending on the age of the home. A newer home constructed of conventional wood framing will often be less costly to remove when compared to an old home constructed of solid masonry. This is because most landfills charge by weight. Also, older homes often run the risk of contamination from things like asbestos and lead-based paint. Both can carry a hefty premium for disposal and may need to be removed individually.

There is also a growing trend of landfills not allowing the disposal of burned structures at all because after a fire, the aforementioned contaminants can not be separated. Debris removal can also be impacted by the quantity and type of personal property that was in the home, as electronics and other harmful content could be present.

## Plans, permits, architectural and engineering fees

House plans and engineering studies typically cannot be resubmitted from an old project. Most municipalities will require a new copy with a recent date to help ensure that the documents meet current building codes. It is possible for building permits in affluent areas to cost tens of thousands of dollars or more, as they are typically based on the size and cost of the project.

## Building code updates

When rebuilding older homes, costs can be incurred with common code updates. These may include things like earthquake-resistant design, energy conservation, property line setbacks and wildfire resistance. Another commonly encountered code update in certain municipalities is for fire sprinkler systems. It is possible that a new home or any home undergoing a significant remodel must have a residential fire sprinkler system installed.

## Logistics

In areas with high population density where lots are small, buildings are in close proximity to one another and streets are narrow. The ability to deliver, store and stage materials can be quite challenging. The same principals can be applied to mountain regions or hillside construction.

## Time

Unfortunately, we do not have the luxury of planning when a loss will occur. If we did, goods and services could be ordered well ahead of time so they are delivered as they are needed on the job site. Items like imported flooring, reclaimed beams or cabinetry that is truly custom designed and built specifically for your home can take extra time to plan, build and deliver. It is very common for higher fees to be charged during the reconstruction of a home in order to received goods and services on an expedited basis.

## Additional considerations

High-quality, mass-produced homes are a growing trend in the United States. Builders of these homes have the ability to buy goods and services in bulk, leveraging economies of scale, then pass some of the savings along to the consumer to gain a competitive edge in the marketplace. However, once a development is finished and the large-scale builder moves on to the next project, it won't return to rebuild one home in the event of a loss. This makes every home at the time of loss a custom home. The local home builder that does not have the buying power to leverage such economies of scale will have higher associated costs before ever driving the first nail.

If you have any questions, please contact your agent or Nationwide Private Client Risk Solutions professional. For more information on how you can help prevent losses, visit [nationwide.com/solutionseries](http://nationwide.com/solutionseries).

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