



Now More Than Ever: The Importance of Insuring Your Home to Value



Current global economic conditions are greatly impacting everyday life in this country. Americans are making adjustments to their discretionary spending, and some have even decided to place home renovation and construction projects on hold. Many assume there is a corresponding decrease in residential construction costs. Plus, as home market values have plunged as much as 30% in parts of the country, some homeowners think insurance premiums should decrease too.

Contrary to popular belief, however, while home market values continue to plummet nationwide, construction costs

remain strong and are even on the rise, although at a slower rate than in the past. The *Engineering News-Record* Construction Cost Indices calculated a 4.9% increase in construction costs from Dec. 2007 to Dec. 2008.

Market value vs. replacement cost

As a result of increased construction costs, approximately 58% of U.S. homes are underinsured by an average of 21%, according to Marshall and Swift/Boeckh, a leading provider of building cost data. Many homeowners don't realize that insurance premium is based on the *replacement cost* to rebuild a home in the event of a major loss, not *market value*, or what the house would sell for today.

MARKET VALUE VARIABLES

Sub-prime loan crisis implications
Foreclosure rates
New housing starts
Housing shortages in some locations
Location factors
Land value

REPLACEMENT COST VARIABLES

Trends in material costs
Fluctuating fuel costs
Labor costs and availability
Changing construction code requirements
Changing construction standards and practices
New technology

Key factors that contribute to rising construction costs

- Fluctuating energy costs.
- Rise in the cost of skilled labor.
- Reduced competition as some builders go out of business.
- Increased overseas demand for raw materials and building products.
- Price increases for roof shingles and wallboard.

Building materials cost increases from Dec. 2007 to Dec. 2008

CONSTRUCTION COST COMPONENT	ANNUAL % INCREASE
Millwork (windows, doors, cabinets)	2.1%
Appliances	4.0%
Concrete Block and Brick	4.7%
Hardware	12.5%
Asphalt Roofing	58.0%
Concrete	3.9%
Gypsum Products (drywall)	7.5%
Paint	16.7%

Sources: *Engineering News-Record*, Marshall and Swift/Boeckh, RSMeans, and Reed Construction Data, 2009.

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Reconstruction costs more than new construction

When rebuilding a home after a loss, contractors must work with and match existing materials, which requires skilled labor that costs more. Plus, when a contractor rebuilds a single home, there are no economies of scale. The cost to rebuild is always higher than the initial cost to build.

Varying profits for general contractors and subcontractors

The replacement cost for a home includes the builder's profit and overhead, which averages 10-20% of the building cost or even more for larger, more ornate homes. Architectural fees for additions and renovations add another 10-15% of building cost. Decorator fees can be as much as 20% added to the total cost, since custom interior designs have to be replicated and integrated.

U.S. environmental factors

Recent natural disasters such as hurricanes in coastal regions, floods in the Midwest, and wildfires in the West have contributed to shortages of building materials and overall cost increases. For example, following Hurricane Katrina in 2005, the costs of materials like concrete, steel and copper increased at a double-digit rate, while the cost of lumber more than doubled. Also, a heightened emphasis on building "green" with environmentally friendly materials and ultra-efficient technology has contributed to rising construction costs.

Rebuilding custom and historic homes

The materials used to reconstruct custom homes or restore historic homes are more expensive than those used to build average homes due to finer quality and the fact that specialized homebuilders buy these materials in relatively small quantities. Also, fewer craftsmen specialize in custom construction and historic renovation, and greater demand for these specialists has led to increased skilled labor costs.

How Chubb calculates replacement costs

To help determine replacement costs for the homes that we insure, our nearly 150 U.S. in-house appraisers are in regular contact with approximately 4,000 contractors, restoration specialists and high-end homebuilders throughout the country. Our construction cost pricing captures local differences for rebuilding homes by region, city or even within a neighborhood. Since actual rebuilding costs vary across the country, national construction cost averages can't be used to calculate the expense to rebuild custom or older homes, where materials must be matched and craftsmanship is more specialized.

Complimentary home appraisal service

Chubb offers complimentary in-home appraisals to help estimate the cost to rebuild in the event of a loss. With experience in local construction and pricing as well as valuation methods for custom, unique and older homes, our appraisers can note a home's architectural details and interior features. The findings are compiled in a home appraisal report, which enables the homeowner, together with an agent or broker, to select the appropriate amount of insurance coverage. Since 1985, our appraisers have performed more than 1 million in-home appraisals. Other insurers simply estimate replacement cost over the phone or via a computer program — without an on-site visit.

Our commitment to insurance to value

Chubb takes great pride in our local marketplace knowledge and ability to work with homeowners and their insurance advisors to help determine appropriate replacement cost values. Construction cost trends are fluid and dynamic, and Chubb will continue to monitor these trends and their impact on home replacement cost valuations throughout 2009, just as we have for well over two decades.

