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A closer look at residential reconstruction costs

Policyholders sometimes have questions regarding the estimated replacement costs established by our team. The following information is designed to help you and your clients understand why reconstruction costs can differ from builder or general contractor estimates for new construction.

Replacement cost factors

The term “replacement cost” refers to the cost of reconstructing the unique features in the residence in today's marketplace using materials and design of similar quality. Determining this figure accurately prepares us to rebuild the residence to the same specifications as the original home at the time of the loss.

A home's replacement cost can include the following:

- Labor and materials required to reconstruct the residence with similar quality, craftsmanship and materials
- Reasonable profit for the builder and subcontractors
- Overhead expenses for the duration of the project
- Licensing fees, filing charges, permit and impact fees
- Insurance and taxes associated with reconstruction
- Architect, engineering and consulting fees
- Costs associated with required code upgrades (i.e. residential sprinkler systems, impact rated glass, non-combustible construction, reinforced foundations, etc.)
- Foundation costs above and below ground
- Interior decorating, including all window treatments, decorative light fixtures, wall coverings, floor coverings and associated interior design fees
- Built-in features that are often upgrades after the home was built or purchased, such as cabinetry, bookcases, entertainment centers, fireplace mantels, custom closets, wet bars, appliances, etc.
- Electronics, often upgrades by the homeowner, such as built-in flat screen televisions, computerized lighting systems, alarms, home theaters, smart house systems, close circuit security cameras, lightning suppression, etc.
- Attached structural features, including garages, carports, decks, covered porches, pergolas, gates, etc.

Additional considerations

Other factors that influence reconstruction costs include:

Buying in bulk and economies of scale

When building several new homes simultaneously, a developer can cut costs in ways that are not available when rebuilding a single home.

- The developer may buy a large parcel of land at a low cost and make money subdividing it into smaller parcels. This enables him to lower his/her profit margin on the cost of the home.
- If several homes are being built, materials can be purchased in bulk at substantial savings.
- Moving subcontractors from one home to another creates “assembly line” efficiencies and savings.
- Site access is less cumbersome during development. Delivery of materials, duration of work hours and traffic congestion do not impact construction costs as they would on a rebuild.

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Time constraints

In the unfortunate event of a total loss, the homeowner may be displaced and living in temporary housing. Therefore, reconstruction often must occur in a shorter period of time than new construction. In addition, labor and material costs can go up when a general contractor needs to pull workforce from another job to work on the new project, or they may pay a premium for materials delivered immediately.

Access and staging issues

When rebuilding or renovating a home in an established neighborhood, a general contractor may be required to adhere to a specific schedule to keep noise and construction from impacting other residences. It may be necessary to park construction vehicles and trailers far away from the jobsite. Hauling materials in established neighborhoods can be much more costly.

Availability of skilled labor

As with the demands to rebuild in a shorter time period, labor costs also can escalate due to the general contractor's inability to find skilled labor and quality craftsmen who can work on high-end, custom homes.

Profit and overhead

A typical margin for profit and overhead for a builder is approximately 20%. General contractors sometimes reduce their profit margin for competitive reasons or during slow seasons. However, research into our recent property damage losses confirms that profit and overhead for reconstruction often exceeds the standard margin for new construction. In addition, architect, consulting and engineering fees can exceed the typical percentages charged for new construction for similar reasons.

Price fluctuations

Reconstruction can be influenced by price instability resulting from the following factors:

- Supply shortages. Adverse economic conditions can force some suppliers to slow production or go out of business, leading to material shortages and higher costs. In addition, international demand for lumber and scrap materials has increased due to the growing requirements of global emerging markets.
- Fuel costs. Fluctuating costs continue to influence shipping charges as well as the price of petroleum-based products such as plastics and asphalt.
- Environmental impact. New codes in many areas impact the choice of construction materials and design of a new home, which can add to the cost to rebuild. In addition, some materials that were readily available when the home was originally built may not be available or may be more expensive, due to new restrictions on harvesting wood or laws protecting endangered species.

If you have any questions, or would like more information, please contact your local risk management specialist or Steve Poux, Senior Vice President, Head of Risk Management Services and Loss Prevention, at 212 458 7911 or stephen.poux@aig.com.



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