Are You Insured to Value?

By: Mitch Freedman

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What it would cost to rebuild your home if something happened to it? The same as what you could sell it for? More or less than what your tax assessment states? There is no right answer, and historically speaking there is little correlation between market, tax assessment, and replacement cost valuations. To most, our home is the most valuable asset we own, but we mistake its market value for what it would cost to build should disaster strike. Granted, we've seen a significant increase in home sale prices these past 12-18 months, as the pandemic has shifted our ideas about how and where we want to live. But very often, believe it or not, the rebuild cost is more than what you'd get from the sale of your property.

Why is that?

Well, since 2019/20, the cost of materials that go into home construction have increased dramatically, at the same time that manpower shortages have led to significant increases in the cost of labor. In 2021 alone, the cost of drywall was up 15.7%, the cost of rough framing/lumber up 34.2%, and the cost of plumbing up 56.3% *(U.S. BLS Monthly Pricing Indexes)*, in no small part due to supply chain challenges that continue to this day. Over the next two years, as many as one million new hires will be needed in the homebuilding space to keep up with current demand for construction (https://cnn.it/3MdrBtQ). This worker demand and corresponding shortage will continue to drive up the cost of labor.

The chief consequence of all this when it comes to insurance - as many as 2 out of 3 homes continue to be underinsured by as much as 35%. That means if your next-door neighbors are adequately insured, statistically speaking there is a good chance you are not. While some insurance companies have built-in inflation riders at renewal to account for rising rebuilding costs, oftentimes this index is insufficient and not keeping up with the rate of inflation in the home-building space. In the case of many insurance carriers, no inflation rider exists at all. Policy limits renew as expiring, leaving the homeowner more exposed as time goes on. If the numbers above for certain materials are any indication, it's hard to believe there isn't a larger underinsurance issue at hand.

How do you solve this issue for your household?

First, find an insurance company that will conduct a full inspection of your home (ideally in person/on site) to verify accurate replacement cost when the policy is first written. And if you've been with your current carrier for an extended period of time, ask them to come out an reassess to make sure you're adequately insured moving forward. Second, make sure your carrier offers Extended/Guaranteed Replacement Cost (GRC) coverage on the dwelling and any other structures on the property (detached garage, swimming pool, shed, fence, etc.), meaning you're covered in full even if the cost to rebuild exceeds the stated policy limit. While most insurance companies provide a cushion above the stated policy limits, they are typically capped at an additional 25%, which is oftentimes still not enough to rebuild after a total loss. The fact is, you never know what it will cost to rebuild until, heaven forbid, you have to go through that process. Carriers that provide GRC coverage will pay to rebuild your home with "like kind and quality" regardless of the ultimate cost to do so.

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These carriers understand not only the inflationary impact of labor and materials, but other key factors that lead to higher rebuild costs after a loss:

- Unreported upgrades – improvements to a home over the years that some may not deem “significant”, but add up and can leave the home underinsured unless GRC coverage is included
- Rebuilding a single home is more expensive since the builder has limited, if any, economy of scale on labor and materials
- Rebuilding to code – compliance with current codes as outlined by local building ordinances increases costs during the rebuild process
- Cleanup and remediation – the removal of debris, clearing of a site, possible environmental remediation, etc. all add up and lead to higher rebuild costs
- Freedom to choose your own contractor – our clients often feel more comfortable working with a particular contractor, designer, or architect that may be more expensive than the average professional. The flexibility to do so is an important factor in choosing an insurer, and of course can lead to higher claims costs

Hypothetical example for illustrative purposes only

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Conclusion

Like many other walks of life, the adage rings true when it comes to homeowners insurance – "you get what you pay for." And while it may cost a bit more to be properly covered up to the full replacement cost of your home, knowing the insurer will have a keen understanding on what it takes to rebuild your home and will pay in full even if more than the policy limits, that piece of mind will help you sleep better at night.

About the Author:

Mitch Freedman

Managing Partner

Mitch Freedman, co-founder and Managing Partner of Freedman Risk Management, LLC, began his insurance career with Aon Corporation in 1999 in their commercial healthcare practice, providing risk management solutions to large integrated delivery systems and managed care organizations. Starting in 2002, he launched, developed and managed the personal insurance brokerage operation for Aon Private Risk Management in Washington, DC. Starting in 2005, he launched, developed and managed the DC-area operation for NFP P&C Private Client Group (formerly Lane McVicker, LLC).

His expertise is in developing, implementing and managing complex insurance and risk management programs for affluent individuals and families. Since 2012, he has been recognized by *Washingtonian* magazine as one of the areas top insurance advisors and by *Northern Virginia* magazine as one of the areas most trusted risk managers. He received both a BA in Political Science and an MBA from Vanderbilt University in Nashville, TN. Mitch has authored a number of articles on personal risk management over the years on topics such as high-valued home insurance, adequate personal liability insurance, and valuables coverage for wine and other collectibles.

Mitch resides in Leesburg, VA with his wife, Audrey, and stepson William. He is an avid golfer, a fan of European football, and a proud supporter of Arsenal Football Club. Mitch is also an active Board Member of Loudoun Junior Golf Association, currently serving as Vice President.

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Questions? Contact our team:

Scott Greenberg, CLU, ChFC, AEP®
Principal
sagreenberg@gwellc.com

David Wexler, CLU, ChFC, AEP®
Principal
dwexler@gwellc.com

Keith Eig, CLU, CLTC
Principal
kmeig@gwellc.com

Matthew Friedson
Senior Insurance Consultant
mfriedson@gwellc.com

Ben Green
Insurance Consultant
bgreen@gwellc.com

Andy Greenberg
Insurance Consultant
agreenberg@gwellc.com

Sarah Quinn
New Business Manager & Underwriter
squinn@gwellc.com

Jessica Alvarez
Client Services Associate
jalvarez@gwellc.com

Michael Barsky, FSA, CFP®
Director of Case Design & Client Services
mbarsky@gwellc.com

Bill Snoke, C(k)P®, CPFA
Director of Qualified Retirement Plans
bsnoke@gwellc.com

Mitch Freedman
mitch@freedmanrisk.com

Juliette Dannucci
juliette@freedmanrisk.com

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