

Declining residential market values spur customer service concerns for insurers

By Scott Amussen, Vice President, Property Solutions, Verisk Insurance Solutions — Underwriting

Upside-down mortgages have become a hallmark of the current housing crisis. The downward trend in the value of residential real estate has resulted in countless instances of homeowners owing more on their mortgage than the house is currently worth. These conditions have affected not only the housing industry but the insurance industry as well.

The cost to rebuild a home now exceeds its market value in many parts of the United States. In some cases, the disparity has grown to overwhelming levels. Most homeowners expect insurance coverage amounts to decrease in line with deflating home values and are disappointed when they find out otherwise.

Xactware, a member of the Verisk Insurance Solutions group at Verisk Analytics, conducts analyses to understand and ultimately explain the differences between market value and replacement cost estimates. Xactware selected several metropolitan areas to compare median home sale prices reported by the National Association of Realtors (NAR) with replacement cost estimates calculated using 360Value®, Xactware’s replacement cost estimation solution.

FIGURE 1: Metropolitan Areas Where Median Estimated for Reconstruction Costs Exceeded the Median Sale Price in the Fourth Quarter of 2012

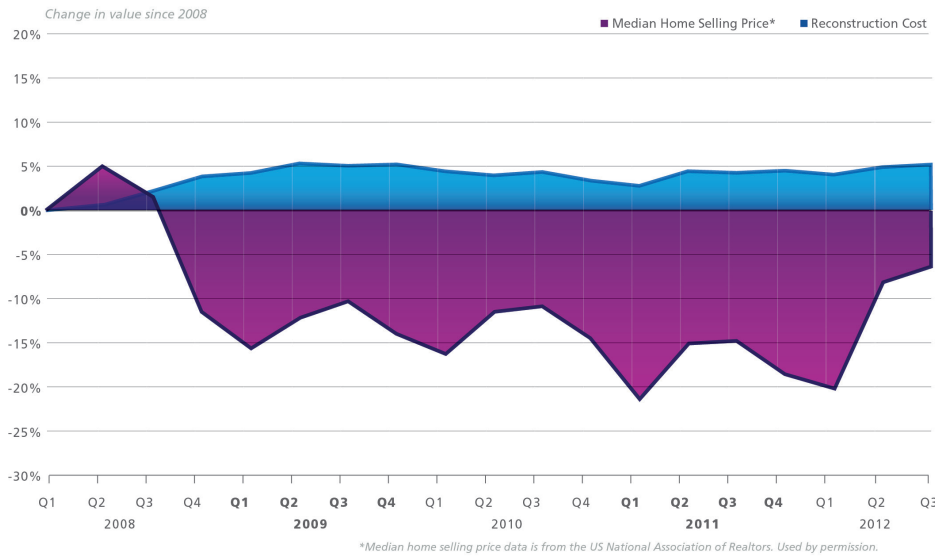
Metropolitan Area	Sale Price	Reconstruction Cost	Percentage Difference
Cape Coral-Fort Myers, FL	\$135,900	\$215,733	59%
Orlando, FL	\$138,400	\$220,000	59%
Phoenix-Mesa-Scottsdale, AZ	\$159,100	\$211,905	33%
Las Vegas-Paradise, NV	\$146,300	\$207,000	41%
Sacramento-Arden-Arcade-Roseville, CA	\$193,200	\$250,489	30%
Riverside-San Bernardino-Ontario, CA	\$209,300	\$259,000	24%
Reno-Sparks, NV	\$185,700	\$216,000	16%

The table shows the difference between median home sale prices reported by NAR with replacement cost estimates calculated using 360Value. We based the results on preliminary NAR data, and they’re subject to change. The NAR data represents single-family homes. The 360Value data represents one-to four-family homes, the majority of which are single family.

The results revealed large disparities between market value and replacement value in many markets, particularly across the Sunbelt where real estate prices have taken the biggest hit. The

results showed that reconstruction costs could be considerably higher than the selling price of homes. The chart in Figure 1 shows data from the first quarter of 2012.

FIGURE 2: Market Value vs. Reconstruction Cost (U.S. Average)



After a dramatic decline in market values in 2007 and 2008, in which the median selling price of single family housing in the U.S. dropped more than 25 percent, the market decline has slowed considerably, showing what may appear to be normal seasonal swings. On the other hand, reconstruction costs — the underlying data behind replacement cost estimates — have remained somewhat steady since early 2009.

Different factors influence changes in market value and reconstruction costs, which contribute to the current disparity between market values and replacement cost estimates.

A Point of Confusion

Often property owners are not aware of the relationship, or lack thereof, between market value and replacement cost estimates. Both pertain to the owned property, but the two values are disparate, independent concepts applied to different uses.

Most property owners are familiar with the concept of market value, the current price at which a property can be bought or sold. Market value includes the land on which a house stands and all related structures, including landscaping, fencing, detached garages, sheds, and swimming pools, among others. Market value varies based on supply and demand of real estate in the local area.

But many property owners do not correctly understand the replacement cost estimate. Xactware defines it as the approximate cost to rebuild a structure with materials of like kind and quality on the original site. A replacement cost estimate does not include the value of the land or any detached structures on the property. The estimate will vary based on fluctuations of local material, labor, and equipment costs used in reconstruction.

While both market value and replacement cost estimates fluctuate, changes may not occur at the same time, speed, or amount. The housing downturn illustrates this concept perfectly because market value has fallen at a much faster pace than reconstruction costs.

Educating Policyholders

Education is essential in overcoming potential customer dissatisfaction when a policy includes a replacement cost estimate that greatly exceeds the market value of the home. To help insurers and agents answer policyholder questions about the difference between market value and replacement cost estimates, Xactware has created a web page — www.xactware.com/marketvalue — that provides an overview and educational information on the topic. ✓



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