

Cost vs Value - calculating future home insurance

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Insurance companies are changing policies from the full replacement type. Mention has been made of keeping up with house values. But the current market value of the house is a totally different figure than the insurable value. Cost does not equal value or in this context, value does not equal cost. But ultimately, cost is the desired insurable value. For example, while an identical house would be similar cost to build in two different localities, the value could be widely different.

The market value of a house, which is analysed from market sales evidence, is the added value it adds to the land. It is part of what is commonly known as the Value of Improvements within the property's market value or capital value. Inevitably this figure is well below the cost to replace.

As a general rule, land values increase and buildings depreciate. One could calculate the indemnity value of the house - that is, the cost to replace less depreciation allowance for age. This figure also may not equate to the market value of the house.

House owners want to be able to replace their home - that is why they have insurance. Anything less will leave them out of pocket.

To calculate replacement cost, one takes the floor measurements and the current cost per square metre to build. One method to estimate building cost, is to use the house modal cost rate. This is the regularly updated cost to build index of a standard basic house. This modal cost rate is then multiplied by an index multiple figure which takes into account the style of the house. For example, a basic "Keith Hay" type home has a multiple of one whereas a villa could be one and a half etc.

I assume that this is what the home owner will now be required to do, then regularly keep it updated for changes in building costs - not changes in market value. And of course pay a premium appropriate for that amount of insurance.

To use a valuer or quantity surveyor to determine the replacement cost and update same will cost the home owner each year - though an astute owner could do it themselves. The question is - why weren't the insurance companies doing this with the present replacement policies? They have the floor areas and they have the resources to complete the calculations. So why can't they do that now? Perhaps that is the intention of a new web site that has been mentioned.