



# CONSULTATIVE SERVICES

## *Appraisal Services Division*



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THAT THERE ARE  
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DESIGNED TO  
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## Differentiating Between the Three Types of Insurance Appraisals: Replacement Cost, Reconstruction Cost and Reproduction Cost

*By Dave Thorpe, Assistant Vice President, Appraisal Services*

When considering having an Appraisal valuation conducted for insurance purposes, it is important to understand that there are various types of appraisals designed to meet different needs. Three common types of insurance appraisals whose end valuations are often confused include:

- Replacement Cost
- Reconstruction Cost
- Reproduction Cost

Each of these appraisals encompasses different methodologies, and results. Traditionally, the insurance industry has utilized Replacement Cost appraisals however there seems to be no clear cut definitive agreement among the brokers, underwriters or carriers. To further confuse matters, by definition there easily can be misunderstanding when the question is asked; which approach to value should be used in a given situation? Let's take a look at how these three approaches to value are defined.

- **Replacement Cost** is the cost to construct or replace at one time, an entire building of equal quality and utility. Modern materials, current methods, designs and layouts are used for replacement. Replacement Cost does not take into consideration improvements necessary to conform to revised building codes, demolition, debris removal, site accessibility or site work, reuse of building components or services, overtime bonuses for labor, soft costs, extraordinary fees, and premiums for material or other contingencies. For insurance purposes the prices used for labor, materials, overhead, profit and fees are those in effect immediately prior to a loss.
- **Reconstruction Cost** is the cost to replicate the structure at current prices using like kind and quality of materials, construction standards, design layout and quality of workmanship. Reconstruction cost also includes a number of site-specific challenges and processes—related costs that are experienced when rebuilding after a loss. These additional expenses are related to repair/restoration contractors, construction process time urgency, limited site mobility, adjoining non-construction areas, the insured's property, economies of scale, dangerous/hazardous materials and mold concerns.
- **Reproduction Cost** of a building is the total cost of construction required to replace the subject building with an exact replica. The terms reproduction or replacement will be somewhat synonymous in newer structures where there are no unique features built into the newer construction. With older structures, a reproduction approach attempts to replace with like components, if possible. A true reproduction in the strictest sense may not always be possible or desirable in the event of totally obsolete or unavailable components. This methodology is used most frequently with historically significant structures.

In most cases insurers and underwriters accept replacement cost appraisals as adequate in determining values for insurance purposes. The process for completing this type of appraisal includes a visit to the structure/building to be appraised, the gathering of building-specific information such as occupancy, square feet, type of construction, number of stories, exterior walls, roof composition, interior finish,

mechanicals, etc. This information is then input into a cost database which calculates the replacement cost.

The most commonly used cost database is the Marshall Swift Boeckh, which is utilized by Gallagher Bassett. There are few subjective observations made by the appraiser, including site conditions that typically include accessibility, site grade and condition of the soil, quality of construction, roof pitch and in some instances, the foundation of the building. Based upon this process, the system will provide a very reliable replacement cost number within the definition of replacement cost.

Reconstruction cost appraisals are in many ways similar to the replacement cost method. The same process is followed; the main difference is that the reconstruction cost appraisal recognizes the significant difficulties that are encountered in a rebuilding situation. The insurance industry states that over ninety percent of property losses are less than total losses. This calls for a rebuilding program, which is significantly more expensive than constructing a brand new building all at once.

Before rebuilding can begin, it must be determined if the remaining structure is capable of being rebuilt. Extensive engineering and architectural analysis have to be done to determine if the remaining structure is safe before rebuilding can be started. If it is determined that rebuilding can take place, in most cases, further demolition will be needed to prepare the remaining shell for reconstruction. Debris removal, site preparation and security all have to take place before construction can begin. In most cases, a structure within the remaining building will be erected to protect what is left of the original building.

This is especially true in cases of church fires and fires that consume a building's roof. One of the most difficult aspects of rebuilding is to match the new construction to the remaining part of the building. Suffice it to say, there are substantial costs involved before actual reconstruction can begin. It has been calculated that rebuilding can easily add an additional twenty to twenty-five percent onto the final bill. Just as in the case of replacement cost appraisals, there is a database to access for this type of appraisal. This is helpful because it keeps the cost of this type of appraisal within a reasonable range.

While it is true that a reconstruction cost insurance appraisal will provide higher values for coverage purposes, clients many times will question the higher premiums associated with this method. In many cases, clients like the additional protection afforded, but don't like the increase in premium.

Reproduction cost appraisals are somewhat different. There is no cost database to access for the information necessary to arrive at costs that can be substantiated. The appraiser will visit the structure to obtain detailed information regarding the building. Most of these types of appraisals involve a historically significant building. In this case, research has to be done relative to the building's significance, including the part it played in the development of the region, where it is located and the origin of the materials used in its initial construction. It must also be determined what architects designed the structure and the craftsmen and artisans that were used to complete the work.

Once all this data has been compiled, the arduous task of obtaining cost information begins. Again, since there is no readily accessible cost database to draw from, the appraiser relies on previous contacts in the trades and long hours of calling people/companies that may have the type of information needed. In most instances, since reproduction cost appraisals involve older buildings and by definition, call for an exact replica, this can be a very time consuming process. A true reproduction cost appraisal in its strictest sense may not always be possible or desirable in the event of totally obsolete or unavailable components.

Based upon Gallagher Bassett's experience in conducting more than forty years of appraisal work, it is our opinion that the Reconstruction Cost Appraisal should be used most often for insurance purposes. There are undoubtedly facts and circumstances in a given situation that would change this conclusion, but in a day-in/day-out environment, we feel this type of appraisal is best for the client. However, it is not up to the appraiser to select the type of appraisal to be utilized. The broker and the client should discuss in detail the risk involved and arrive at a conclusion that is in the best interest of the client.

**For more information on Gallagher Bassett's Appraisal Services, please contact Dave Thorpe, Assistant Vice President at 630-285-3519 or send an e-mail to [Dave\\_Thorpe@gbtpa.com](mailto:Dave_Thorpe@gbtpa.com).**



**BASED UPON  
GALLAGHER  
BASSETT'S  
EXPERIENCE, IT IS  
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MOST OFTEN FOR  
INSURANCE  
PURPOSES.**



Gallagher Bassett Services, Inc.  
Two Pierce Place  
Itasca, IL 60143  
[www.gallagherbassett.com](http://www.gallagherbassett.com)