AssetWORKS

2019-2024 Property Valuation Trends

A look back and ahead at property valuation trend factors for the United States

Report Prepared by AssetWorks (February 2023)

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INTRODUCTION

For any organization, being exposed to risk is inevitable, which means being prepared in the event of a risk occurrence is extremely important. When it comes to property and casualty insurance, part of that preparation is having a good understanding of replacement cost value – the amount required to replace an entire property in like utility and function – for the properties on your statement of values.

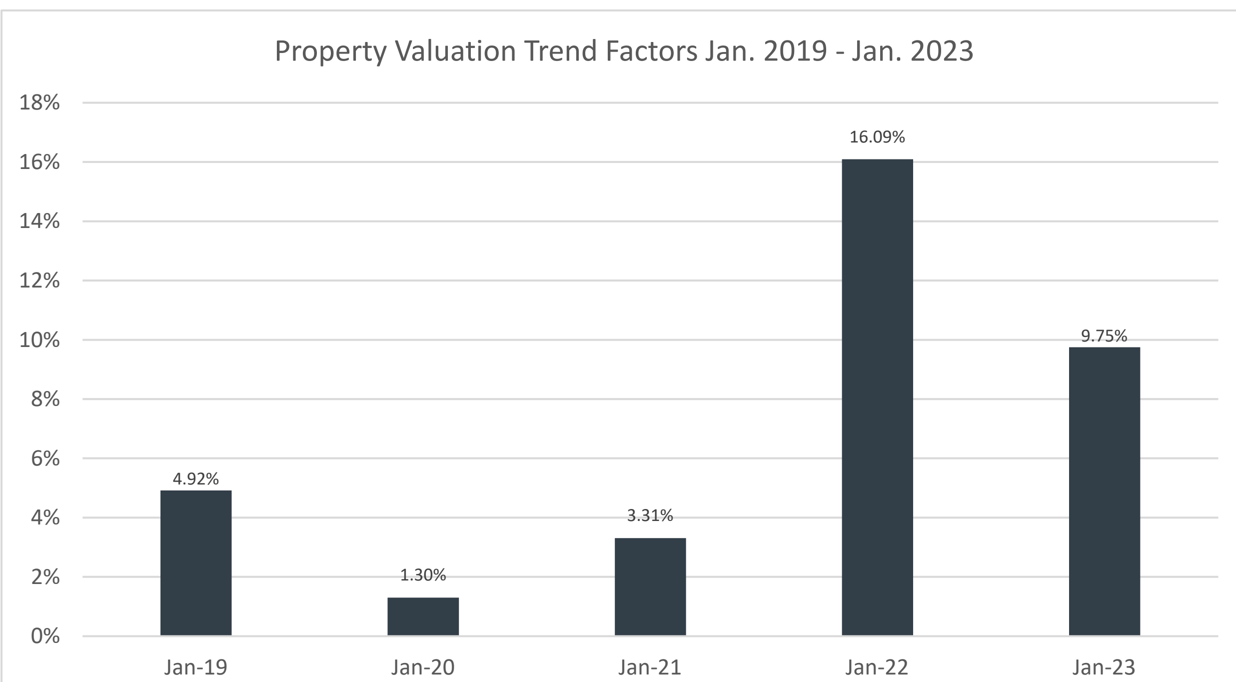
Replacement cost is based on current market prices for labor, materials, equipment, contractor's overhead, profit, and fees. It does not include provisions for overtime, bonuses, or premiums on materials. Over the past five years, factors like inflation, macroeconomic events, and market fluctuations have caused replacement cost values — and as a result property valuation trends — to increase, leading to a recommendation to apply pretty significant trends in January 2022 and January 2023.

In this report, we'll take a look at how trend factors varied from 2019 to 2023 for the United States. We'll examine what impacted those trend factors before turning our attention to what we might expect to see in 2024.

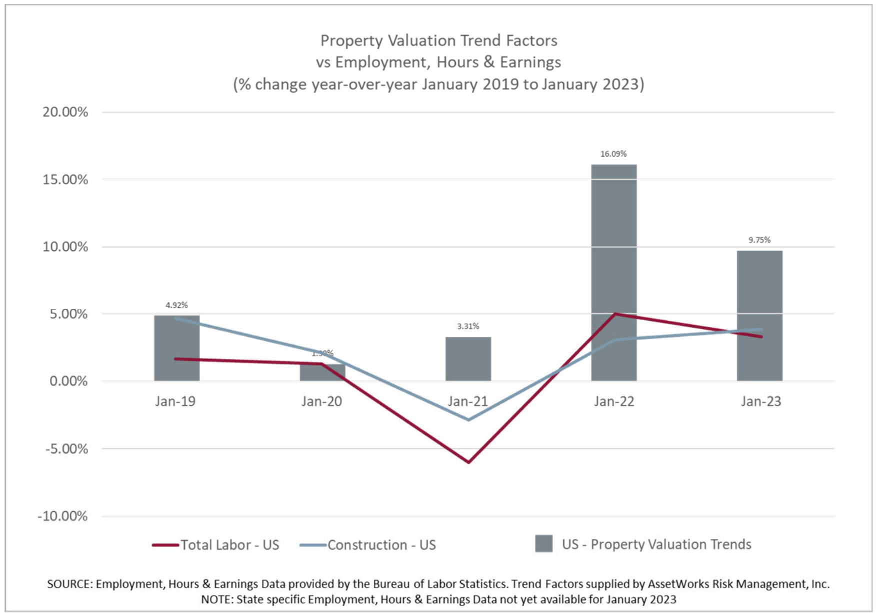
TREND FACTORS 2019-2023

In most years, it's not uncommon to see an upward trend in replacement cost value. That trend is generally somewhere in the 2-4% range, tracking closely with inflation but varying by locality. Though from 2019 through 2023, valuation trends (and inflation) saw a bit more volatility due to the impact of macroeconomic events and market fluctuations on supply and demand.

Generally, the two biggest factors impacting replacement (and construction) costs are the cost of labor and the cost of materials.



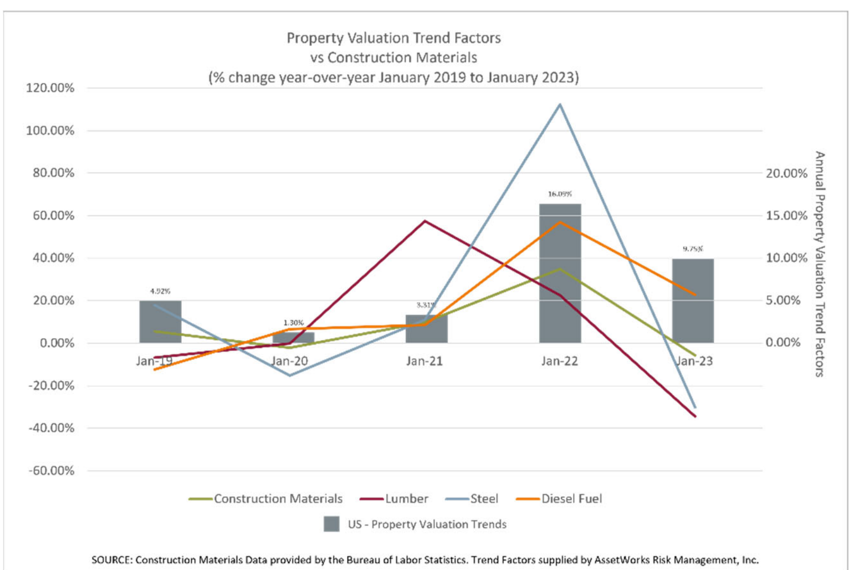
The Cost of Labor



The Bureau of Labor Statistics (BLS) defines Employment, Hours, and Earnings as "monthly and annual average nonfarm payroll estimates for: all employees, women workers, production workers, average weekly hours, average hourly earnings, average weekly earnings, and average overtime." Over the past five years, the most notable event impacting this statistic was the onset of the COVID-19 pandemic in 2020. At this time, construction demand dropped and, according to Associated General Contractors of America (AGC), nearly 1.1 million employees left the industry from February 2020 to April 2020. This departure of qualified labor, along with an increase in demand, has contributed to the labor shortage the industry faces today and, as a result, is also a factor contributing to higher-than-normal trends in replacement cost values.

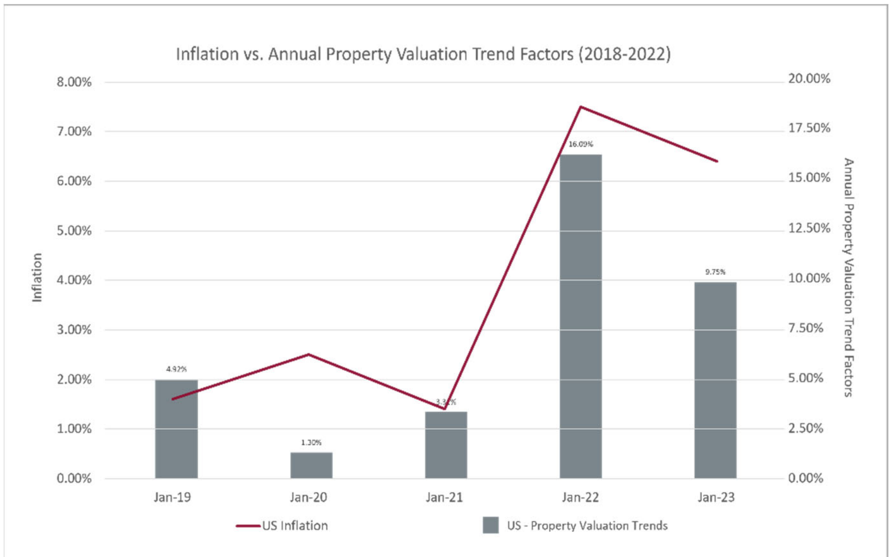
The Cost of Materials

Along with the cost of labor, the cost of materials has a significant impact on construction costs. Data supplied by the BLS Producer Price Index shows how the cost of materials critical to the construction industry has trended over the past five years. While anyone taking on a home improvement project during the COVID-19 pandemic could tell you the price of lumber went up, it's the rising cost of diesel fuel that's taking its turn in the spotlight. Like the other factors discussed, there are many events impacting the cost of diesel. The largest and most talked about is Russia's war in Ukraine. According to *The New York Times'* coverage of rising diesel costs, Russia is a major exporter of both diesel and the crude oil used to make diesel. Other factors impacting the cost of materials are the implementation of tariffs (e.g. China, Canadian lumber), supply chain issues, and increased demand (e.g. Infrastructure Investment & Jobs Act).



Inflation

Inflation is the increase in the price of goods and services over time. It is directly related to the cost of materials and also has an impact on the cost of labor; when purchasing power declines, there is greater demand placed on wages. The recent rise in inflation came on quickly. Executing monetary policy to manage it will require striking a delicate balance to keep the economy and employment from suffering.

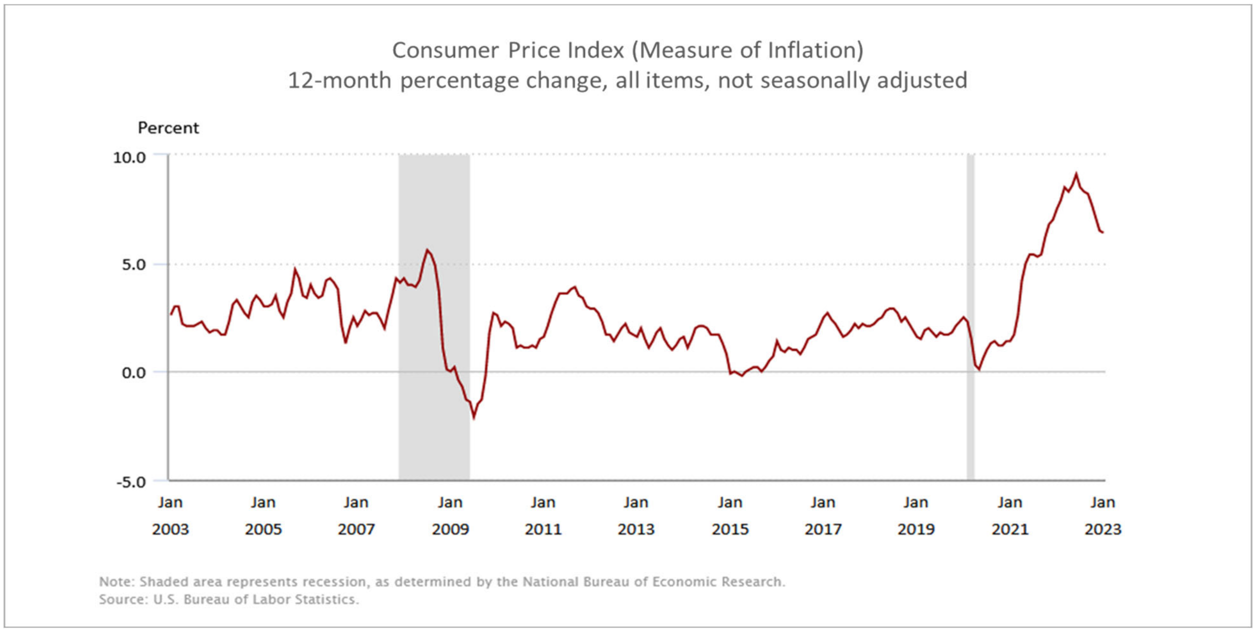


Summary

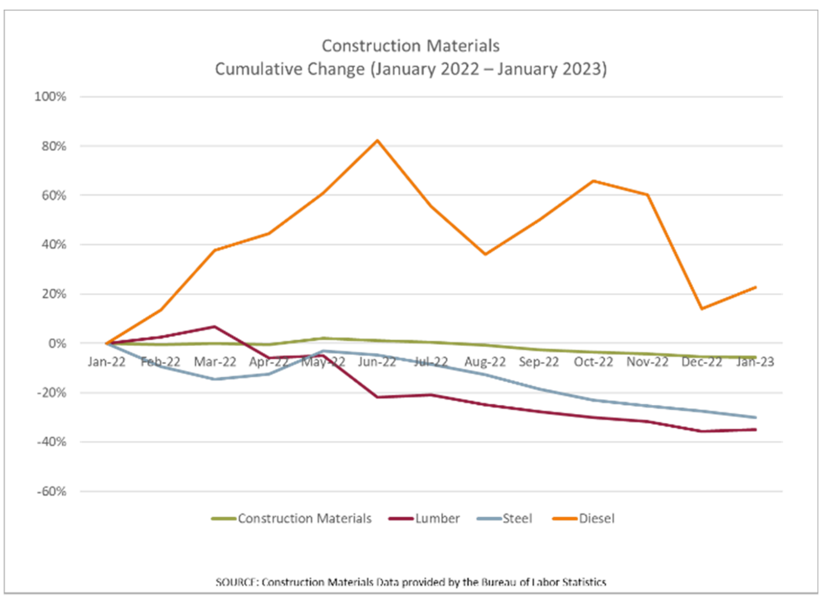
In any given year, property valuation trends for replacement cost can be expected to closely reflect trends in the cost of labor and the cost of materials. Inflation can be a good proxy for how these variables are trending. Overall, the costs of labor and materials are largely driven by supply and demand, which are impacted by macroeconomic events like natural disasters, geopolitical events, government policy, and more. From 2018 through 2020, many factors pushed and pulled to keep property valuation trends in the US, for January 2019 to January 2021, between about 1% and 5%. However, starting in 2021 and continuing through 2022, a combination of events, notably labor shortages, tariffs/trade challenges, and supply chain issues (e.g., diesel), drove property valuation trends above 15%.

WHAT TO EXPECT IN 2023

It is a challenge to predict exactly what will happen with construction costs and insurable values in the future, but some assumptions can be made based on the historical data that is available. For long-term planning purposes (the next 5 to 10 years) it is safe to assume that construction costs will increase overtime. It is also fairly safe to assume that, like inflation, valuation trends will likely (eventually) settle back down to somewhere in the 2-4% range.



The much more difficult task is forecasting the short term because, as we've witnessed, macroeconomic events can have a significant impact and are not always foreseen. That said, CBRE, the world's largest commercial real estate and investment company and the largest commercial property developer in the United States, publishes an annual construction cost trends report. Their latest report (issued July 6, 2022) projects that rising construction costs should stabilize in the 2-4% range in 2023 and 2024.



Taking a look at the data, while the industry forecasts labor shortages to continue and costs to remain high, the months between January 2022 and January 2023, show an overall downward trend in the cost of materials. As the year continues, closely monitoring cost and labor trends as well as natural disasters, geopolitical events, government policy, etc. will be important to knowing in which direction and to what degree replacement cost values will trend.

HELPFUL RESOURCES

CBRE 2022 US Construction Cost Trends Report
https://www.cbre.com/insights/books/2022-us-construction-cost-trends

Association of General Contractors of America 2022 Inflation Alert
https://www.agc.org/sites/default/files/users/user21902/Construction%20Inflation%20Alert%20Cover%20-%20Feb%202022_000.pdf

New York Times Coverage on Soaring Costs of Diesel -
https://www.nytimes.com/2022/03/31/business/economy/diesel-economy-russia-ukraine.html
https://www.nytimes.com/2022/11/10/business/energy-environment/diesel-prices-inflation.html

Construction Dive: 5 Charts Hint at What's in Store
https://www.constructiondive.com/news/5-charts-hint-at-whats-in-store-construction-economy-2023/638059/