

When a storm takes the roof, or a pipe bursts on a long weekend, the number that matters is not what the property could have sold for last month. Insurers pay to repair or rebuild, and the yardstick they use often has little to do with listing prices or cap rates. That gap blindsides owners more often than you might think, especially with construction costs in flux and policy wording that shifts from one renewal to the next. Understanding the difference between replacement cost and market value can mean the difference between a smooth claim and a capital call at the worst possible moment.

I have sat with owners who bought a building for 3.2 million, felt prudent insuring it for three, then learned after a fire that a compliant rebuild would cost closer to four. I have also seen the reverse, a dated suburban office tower insured for an inflated figure because the policy had not been reviewed in years, while its market value slid due to soft leasing. Both owners thought they were covered. Neither number was wrong in its own domain. They were just measuring different realities.

Two values, two purposes

Market value is the price a willing buyer and seller would agree to, neither under compulsion, in an open market. It is anchored in comparable sales, income potential, and investor sentiment. A real estate appraiser leans on the sales comparison, income capitalization, and sometimes the cost approach to triangulate that number. It reflects the property as an investment.

Replacement cost, for insurance, is the cost to rebuild the improvements with new materials of like kind and quality, at current construction rates, on the same site. It does not care what the building could sell for. It cares how many cubic yards of concrete sit in the parkade, what it will cost to replicate the curtain wall, whether updated codes demand sprinklers or seismic bracing, and what local labor charges per hour today, not two years ago. A property appraisal can include a replacement cost estimate, but the methodology diverges from market valuation.

There is also actual cash value, a term that confuses many. Insurers sometimes define it as replacement cost less depreciation. In practice, actual cash value may pay out less than what it would cost to reconstruct, and it can leave owners short if they have not read the policy closely.

Why market value fails as an insurance benchmark

Consider a single-tenant light industrial property on the edge of town, 40,000 square feet [Real estate consultant](#) at a 22-foot clear height, erected in the 1990s. It sits on four acres of land. Demand for that location has softened, vacancies ticked up, and capitalization rates widened. Market value has slid to 4.7 million based on income and local comparables. Now, ask what it would cost to rebuild. The structure is a steel frame with insulated panels. The site has heavy power service, a sprinkler system, and a large paved yard. Local contractors quote 170 to 200 per square foot, depending on lead times and materials. At 185 per foot, the hard construction cost alone is 7.4 million, before fees, permits, and site work. Market value and replacement cost are not in the same orbit. They are answering different questions.

Market value bakes in land value, location risk, tenancy strength, and investor required return. Replacement cost does not. Conversely, replacement cost embeds the cost of mobilizing cranes, the scarcity of drywall, the escalation clause in the general contractor's bid, which market value ignores. If you insure to market value, you risk co-insurance penalties and underinsurance at the claim stage. If you insure to a bloated cost figure without thought, you overpay premiums for years.

How a real estate appraiser approaches replacement cost for insurance

The workflow differs from a typical commercial property appraisal built for financing or sale. A real estate appraiser begins with the structure itself, not the cap rate. The task is to model the components that must be rebuilt, quantify them, and price them with defensible data sources. In practice, that typically involves:

- A detailed site and building inspection that captures gross floor area, structural system, foundation type, floor loading, cladding, roofing, mechanical and electrical systems, fire protection, vertical transportation, and any special features like cold storage, clean rooms, or lab space. A laser measure and camera are standard, but experience counts more. You need to see, for instance, that the mezzanine is structural steel with composite deck, not wood, and that the RTUs are 30 tons each.
- A line-item cost model using a recognized database, adjusted for local conditions. I prefer to blend sources: RSMeans assemblies for granularity, local contractor feedback for live pricing on steel and concrete, and recent tender results when available. Assemblies avoid the trap of all-in averages that miss project complexity. For a mid-

rise office, I will break out substructure, superstructure, envelope, interior finishes, HVAC, electrical, plumbing, elevators, fire protection, and site works.

- Soft costs and fees layered on top. Architecture and engineering, permits, development charges, financing during construction, general conditions, overhead, and profit add materially to the number. In Ontario, those can add 20 to 35 percent depending on project scale and complexity.
- A code and bylaw review. Many policies exclude bylaw upgrades unless explicitly endorsed. If a 1960s apartment building lacks sprinklers, and a rebuild triggers full NFPA compliance, the cost delta can be significant. The appraiser must flag this risk and, where policies include bylaw coverage, include an allowance.
- A time and escalation factor. A 20-month rebuild in a rising cost environment requires an escalation allowance. I model escalation explicitly when volatility is high, applying a compounding percentage over the construction period. In steady markets, a contingency allowance can absorb this.

The output is a replacement cost new estimate, sometimes accompanied by a reproduction cost estimate when heritage or unique finishes are at play. Reproduction cost aims to recreate original materials and methods, which can be several steps more expensive than replacement with modern equivalents. For insurance purposes, policies usually define replacement using like kind and quality, not historical replication, unless specified.

Where the land sits in this discussion

Insurance typically covers the improvements, not the land. In commercial property appraisal, land value is a component of market value. In insurance valuation, land value is out unless the policy says otherwise. That matters for high land value markets. A downtown site might be worth more than the building. Market value can be 15 million, with only 6 million allocated to the improvements. If the building burns down, the insurer is concerned with what it costs to rebuild the improvements, not the land. Confusing the two figures leads to big surprises.

There is also the decision set available to the owner. After a major loss, an owner might decide not to rebuild on site. Market value is the relevant number if the property is going to be sold as is for redevelopment. Insurance proceeds, however, are tied to the cost to repair or rebuild, and many policies require reinstatement on site to recover full replacement cost. Some allow rebuilding at another site with conditions. Read the fine print.

The code upgrade trap

Bylaw coverage is one of the most common gaps we find during real estate advisory engagements for portfolio owners. An apartment building erected in 1975 might have narrow stairwells, old glazing, and no sprinklers. If the policy covers only the cost to put it back as it was, and excludes code-required upgrades, the owner will fund the difference. A modest looking fire in one wing of a retirement home once triggered an entire building sprinkler retrofit because repairs exceeded a percentage threshold that activated full code compliance. The code-driven portion of the work exceeded the visible damage by a factor of three. Insurable value should anticipate this where the policy allows, and owners should negotiate endorsements that bring bylaw coverage up to realistic levels.

Depreciation and actual cash value

Some policies, especially on older industrial assets, are written on an actual cash value basis to lower premiums. The theory is straightforward: take the replacement cost new, subtract depreciation for age and condition, and that is your coverage limit. In practice, the calculation can be messy. Depreciation is not the same as economic obsolescence. A concrete frame has a different life than a membrane roof. Mechanical equipment may be near the end of its service life and heavily depreciated, while the structure has decades left. If you insure on an actual cash value basis, insist on a depreciation schedule that matches building components, not a blunt 40 percent haircut.

The more consequential issue is cash flow. Actual cash value typically pays out the depreciated amount upfront. To receive the holdback, you need to complete repairs or rebuild within a specified time and submit proof. If you do not rebuild, you may be stuck with the depreciated payout. For owners without ready capital, that can delay the project or stall it completely.

Market value in the background

It might sound like market value has no role here, but it does come into play in two ways. First, it informs strategic decisions. If replacement cost dwarfs market value, the owner may prefer a cash settlement and a sale for land value. We saw this with a small retail plaza on a site zoned for high-rise. The cost to rebuild the aging strip was higher than its likely sale price as an income property, but the land had significant redevelopment potential. The insurer made an actual cash value settlement, the owner sold the site, and everyone avoided a rebuild that did not make economic sense. Second, market value drives co-insurance calculations when insurers use percentages tied to value. Misunderstand those, and you can be penalized even if your insured limit seems high.



Co-insurance and the penalty that surprises people

Co-insurance clauses require the insured to carry a certain percentage of the property's insurable value, often 80, 90, or 100 percent. If you carry less, a penalty applies to partial losses. That penalty is proportional, and it can bite hard. Imagine a warehouse with a correct replacement cost of 10 million. The policy has a 90 percent co-insurance clause, so you should carry at least 9 million. You set a limit of 6 million, thinking it will cover any plausible loss. A fire causes 2

million of damage. Because you were 33 percent under the required amount, the insurer pays only two thirds of the loss, less deductible. You fund the remaining third out of pocket. Few owners enjoy that math lesson after the fact.

This is where a real estate advisory team earns its fee. A disciplined property appraisal for insurance purposes sets a credible insurable value and aligns policy terms so the co-insurance percentage works in practice.

Commercial versus residential nuances

Residential properties are simpler to model and insure, though even there, missteps happen. A custom home with imported stone, millwork, and in-floor heating will not be replaced at the same cost per square foot as a production build. In commercial property appraisal, the spread widens. A medical office building with specialized ventilation and backup power is a different animal from a garden-variety suburban office. Cold storage facilities, food processing plants, data centers, and laboratories each have systems that can dwarf base building costs. If you lump them under a generic cost rate, you will be wrong, and likely light.

A practical example: a small biotech lab in a flex building in London, Ontario had roughly 9,000 square feet of tenant improvements with fume hoods, specialty gas lines, and vibration control for certain equipment. The base building replacement was about 170 per square foot. The lab build-out added another 250 per square foot. The tenant expected the landlord's policy to cover everything. It did not. The lease made the tenant responsible for insuring its improvements. When a water line failed, the dispute took months to resolve and work stalled. Clear delineation of who insures what, paired with accurate valuation, prevents that kind of pain.

London, Ontario cost reality check

Costs vary by market and over time. In our work as real estate appraisers in London, Ontario, we maintain live cost files from contractor quotes, tender results, and completed projects. Pre-pandemic, a mid-rise wood-frame apartment could be built for 170 to 200 per square foot hard cost in this region. By late 2023 and into 2024, that band shifted to 230 to 280 for similar product, depending on specifications and timing. Concrete construction for mid-rise to high-rise ranges more widely, from 300 to 450 per square foot on hard costs for straightforward designs. Full-in replacement cost for insurance includes soft costs and often contingency, which can push all-in figures 20 to 35 percent higher.

Industrial tilt-up saw volatile concrete and steel prices, with assembly and erection availability driving premiums. At points, steel packages doubled over a two-year stretch. If your policy relied on a 2020 appraisal, you are probably underinsured today. A refresh is cheap compared to a co-insurance penalty.

Engaging a real estate appraiser in London, Ontario who actively tracks these inputs pays dividends. The same logic applies in any market: local data, not national averages.

Data sources and judgment

Cost guides like RSMeans or Altus Group are useful. So are insurer worksheets and simple cost-per-foot calculators. None substitute for professional judgment. A roof described as "modified bitumen" in a file might, on inspection, be a fully adhered two-ply SBS with a concrete deck, not a steel deck. An elevator described as "two cabs" might be two 3,500-pound machines or two 2,000-pound dumbwaiters. The cost delta is real. A real estate appraiser asks, looks, and verifies. They also phone subs. Mechanical contractors will tell you how much air that rooftop unit is moving and what a current replacement looks like. Electricians will know what a service upgrade costs today. The point is not to over-engineer every estimate. It is to avoid the big misses that lead to gaps in coverage.

The policy side: matching valuation to wording

Words on a policy sheet are not decoration. They determine how a claim gets adjusted. If the policy defines replacement cost as "cost to replace with like kind and quality without deduction for depreciation," that is different from "cost to repair or replace, subject to depreciation on materials." Some policies cap code compliance coverages as a sublimit, say 500,000. That number might be fine for a small office, not for a hospital wing. Deductible structures can be percentage based for wind or quake, which changes the retained loss at higher values.

One more wrinkle, blanket coverage across a portfolio. Owners with multiple buildings sometimes carry a blanket limit that floats over the group. It can reduce premiums and offer flexibility. Insurers then require a statement of values by location. If those statements understate replacement cost at one or more sites, co-insurance penalties can still apply on a

location-by-location basis. A clean set of statements of values, supported by a credible property appraisal for each significant asset, is the backbone of a good blanket program.

How often to revisit the number

Annual indexation clauses that bump the insured value by a set percentage are a good start, not a solution. If steel spiked 25 percent, your 4 percent escalation rider will not save you. In stable periods, I recommend a formal update every three years for most commercial properties, with interim indexing off a cost index we trust. For specialized assets or during volatile markets, update annually. For portfolios, rotate through major assets so that no significant property goes more than two years without a look.

This cadence also reduces friction [real estate consultant advice](#) with lenders. Many lenders now ask for evidence that insured values align with believable replacement costs, especially for commercial property appraisal files in refinancing. A current appraisal with a clearly documented replacement cost schedule keeps the loan closing on track.

Valuation method clarity: replacement, reproduction, and functional obsolescence

Not every building should be replaced as it stands. Think of a 1950s school converted to offices, complete with gymnasium and a pool filled in with gravel when the conversion happened. Reproducing that building, with its thick masonry and odd floorplate, might be much more expensive than replacing it with a simple modern office. Insurance language can specify replacement with modern materials, which avoids locking you into a costly reproduction. At the same time, certain features drive replacement costs no matter what, such as a deep basement or underground parking that cannot be value-engineered away if you plan to restore the previous use.

Functional obsolescence complicates the analysis. A large open atrium in an office reduces rentable area. Market value might reflect that negatively. Replacement cost, however, has to build the atrium if you want the same building back. The two values split further apart.

Real cases that sharpen judgment

After a hailstorm damaged several buildings on a light industrial campus, we reviewed the insured values. Roofs had been replaced piecemeal over time. One building had a 60-mil TPO, another a two-ply SBS, another an old BUR with gravel. Replacement costs were not equal. The policy carried a single per-square-foot roof figure across all structures. Adjusters quickly challenged it. The owner had enough documentation to argue building by building because a prior property appraisal had logged construction details. The claim settled faster and for more accurate amounts than it would have otherwise.

Another example involves a mixed-use building downtown with retail at grade and apartments above. Its heritage facade came with a municipal designation. Rebuilding a heritage facade is not the same as replacing stucco. Stone carving, sourcing matching brick, and custom window profiles pushed reproduction costs above simple replacement. The owner had engaged a real estate appraiser earlier to document these elements. The insurer agreed to a facade-specific sublimit increase. When a water main break soaked the foundation and damaged the facade, that preparation paid off.

Practical steps for owners and managers

Here is a short checklist that pairs action with outcome, without dragging you into jargon.

- Define the purpose up front: finance, sale, or insurance. Tell your real estate appraiser which number you need.
- Document the building: plans, permits, major upgrades, and system specifications. Keep it in a single folder shared with your broker and advisory team.
- Demand component-level costing for complex assets. A single cost-per-foot figure is a red flag on labs, food processing, healthcare, and data centers.
- Align policy wording with the valuation: replacement vs reproduction, bylaw coverage limits, co-insurance terms, and deductible structure.
- Refresh on a schedule that matches volatility: annually for specialized or high-value assets during cost swings, every two to three years otherwise, with interim indexing.

The London, Ontario perspective on providers and process

In a mid-sized market like London, relationships matter. Real estate advisory firms here often straddle traditional property appraisal and hands-on cost verification. A real estate appraiser in London, Ontario who also knows local contractors, permitting timelines, and inspection practices brings more than a spreadsheet to the table. They can tell you that a downtown lane closure for a crane requires a particular municipal permit and will add a week and a fee to a project. They can price a hydro service upgrade because they have seen London Hydro's current queue. These are small lines in a model that, cumulatively, move the insured value.

For commercial property appraisal in London, Ontario, we capture nuances that outsiders miss. For instance, post-tensioned slabs show up more often in certain eras of downtown buildings here, which changes repair methodology after a loss. Local aggregate sources influence concrete pricing. Winter conditions are real, and cold-weather pours need additives and blankets that raise costs. These regional details rarely appear in national cost guides. Local knowledge keeps you within the fairway.

The tenant-landlord boundary in valuation

Leases carve up responsibility. In triple-net leases, tenants often insure their leasehold improvements and contents, while landlords insure base building elements. In gross or modified gross leases, lines blur. Before a loss, get an inventory of tenant improvements and their replacement costs. If you manage a multi-tenant building, maintain a schedule of each unit's upgrades with approximate replacement figures. After a flood, trying to reconstruct who paid for what from old emails is a nightmare. Better to know in advance that Unit 204 has a 150,000 dental fit-out and that the lease assigns insurance responsibilities accordingly.

Edge cases that need specialized treatment

- Heritage and designated properties: reproduction costs dominate. Secure a valuation that isolates facade and ornamental features. Ensure your policy mirrors that reality with sublimits or endorsements.
- Agricultural buildings: pole barns, greenhouses, and specialized barns have cost profiles that differ from standard industrial construction. Polycarbonate panels, fans, and irrigation systems require targeted pricing.
- Condominium corporations: the declaration often defines standard unit finishes, and insurance must align to that definition. The corporation insures common elements and standard units, while owners carry coverage for improvements and contents. A clear standard unit by-law simplifies claims.
- Mixed construction: properties with a mix of wood frame and concrete or steel need segmented models. A blanket per-foot figure across the whole structure leads to errors.
- Environmental and contamination risks: insurance may exclude or limit coverage for contamination cleanup. If your building houses processes with potential for contamination, factor that into your risk and capital reserves, not just the insured value.

Working with brokers, adjusters, and lenders

Your broker is the translator between valuation and policy language. Share the appraisal in full. If you are worried about competitive sensitivity, ask the appraiser to prepare an insurer-facing summary with enough technical detail to back up the numbers. Adjusters appreciate line-item logic during a claim. Lenders get comfort from a current appraisal and an insured limit that matches it. Align all three and the machinery moves smoothly.

Final thoughts that steer decisions

Replacement cost and market value live beside each other, not on top of each other. One tells you what it costs to rebuild. The other tells you what an investor would pay. If you manage them as if they are the same, you will either overpay premiums or risk a painful gap when a loss occurs. Bring a qualified real estate appraiser into the conversation early, especially for commercial property appraisal where complexity creeps in. Use that expertise to set insured values that tie to your policy wording, revisit them on a sensible cadence, and document the building in enough detail that you could hand the file to an adjuster tomorrow.

Owners who do this sleep better. When the phone rings at 2 a.m., they are not guessing. They know the policy fits the asset, the number reflects the cost to put it back, and the team around them will carry the weight. That confidence is the quiet return on a careful approach to real estate valuation for insurance.