

# So Why is Insurance To Value Important?

Originally, property insurance was designed to restore the owner of damaged property back to the same position they were in before the loss in relation to the value of that property. To accomplish this, settlement was made at the actual cash value (ACV) of the property which was calculated as the cost new less depreciation. This would approximate what the property was worth at the time of loss. However, the insured would have to pay the difference to replace the damaged property with new.

As one way to resolve this dilemma, insurers introduced a replacement cost feature. While ACV is still one of the several options available in settling property losses, replacement cost is now the norm in almost all homeowners policies and in most commercial property policies as well. When a loss is settled on the replacement cost basis, the insurer will pay to replace the damaged property with materials of similar kind and quality capped, of course, at no more than the limit stated in the policy declarations for that coverage.

Insurers include a coinsurance clause in homeowners policies, and most other property insurance forms, as one way to make sure they will generate sufficient premium to pay for the losses. Coinsurance compels the insured to cover the dwelling for at least a certain percentage, usually 80%, of its replacement value or face a reduced payment (coinsurance penalty) in the event of a loss. This penalty applies not just to a total loss but also to partial losses. Since the insured would be responsible for this difference, the appropriate insurance to value coverage amount needs to be established. Other coverages in the policy for personal property and any additional living expenses are usually set at a percentage of the dwelling limit. The personal



property limit is typically 50% to 60% of the dwelling coverage limit. Correct valuation of the dwelling limit is then also essential to provide adequate protection for the insured's contents.

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Many insurers include an automatic annual adjustment in the dwelling limit to recognize that costs to rebuild typically increase from year to year. This limit increase, known as inflation guard or inflation protection, is designed to prevent an insured from suffering a coinsurance penalty when the original policy limit was adequate, but would fall behind over the years. There may be other changes in the dwelling that an automatic increase will not take into account. Remodeling, renovating and additions can drastically change the replacement value of a dwelling. Replacing a kitchen or finishing a basement can increase the home's value by \$10,000, \$20,000 or more. The insured should alert their agent or company so that the policy limit can be revised to properly identify a change like this. Some insurers may reinspect or reevaluate a property after being insured for a number of years to see if the valuation needs adjusting.

As a result of the economic difficulties of the past two years, the

price of homes declined across the country in almost all markets. Many insureds wonder why their homeowners insurance premium didn't change as well to reflect the reduction in the selling price of their home. Insureds need to understand that the premium for their home is based on the cost to rebuild the home and not its market or real estate value. The costs to rebuild a property do not necessarily fluctuate along with the market value of that property. While the market value of a home may be holding steady or declining, the costs to rebuild could be increasing. Different economic factors affect the resale value of a home and the price to rebuild. The availability and cost of labor and materials and changes in construction codes impact the rebuilding cost of a home.

Consequently insurance to value is important to both the insured and the insurer. It provides enough insurance coverage to allow the insured to rebuild the home while providing the insurer with a requisite amount of premium to pay claims. This same reasoning also applies to commercial buildings as well.

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