Pierson and Scott, Inc.

"Insuring Excellence"

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Property Valuation Methods and Co-insurance

Different insurance carriers, different types of insurance policies, and different options within policies, allow for or require different types of valuation of real property. Understanding the definition of these values is vital in understanding your policy and in making choices about what type of coverage you are able to purchase.

Replacement Cost---valuation provision that replaces old damage property with new replacement property at today's replacement or reconstruction cost, without any deduction for depreciation. In order to determine this cost, your agent will ask detailed questions about not only square footage, but also types of flooring, wall coverings, grade of appliances and bathrooms, and many other finishing details. Agents have access to computer software that helps us to calculate the replacement cost of commercial and residential structures.

Actual Cash Value (ACV)—the basic valuation provision found in property policies, determined by subtracting depreciation from the property's replacement value. In a nutshell, the valuator determines what it would cost to rebuild the property, and then applies a depreciation factor based on the age of the materials. In the example of a kitchen fire loss, you would be given the value of the kitchen but would not have enough to replace it. (refer below to co-insurance)

Functional Replacement Cost---basic valuation provision that permits the insurer to replace damaged property with a functional equivalent. Used with older properties. In a nutshell, the valuator determines what it would cost to replace the property with a functional equivalent. Used or lower-grade parts might be brought in for the replacement. For example, if you have a kitchen fire in an older kitchen that had contained solid wood cabinets, a low-grade laminate cabinet might be brought in, and vinyl flooring would replace the damaged oak flooring. In the end, you would have a functional kitchen but it would not be the high-grade kitchen that had existed before the loss.

Market Value---The price one would pay based upon free market conditions, adjusting for supply and demand. Example: You might buy a house in an older section of town where properties are a bit run-down, and school districts and local services are sub-par because the tax-base has eroded. The purchase price is $60,000. However, if you were to rebuild that house (Replacement value), the current construction cost of that house is $180,000 (for similar style and square-footage and comparable materials). If you pick that house up and move it to an up-scale section of town, the market value might be $250,000 because of the added value of a high-end neighborhood. While realtors are concerned with market value, the insurance industry generally is not. There are, however, a few insurance carriers who are willing to issue a policy limited to the Market value of a property. These are usually issued when the Market value is significantly lower than the Replacement cost.

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Co-insurance---common property provision that requires an insured to carry insurance limits equal to a specified percentage (often at least 80%) of a property's actual cash value in return for a reduced rate. If a coinsurance requirement is part of your policy provisions, it is imperative that you have your agent calculate the ACV and then make sure that your property limit is at least 80% of that. This should be checked periodically, as construction costs change in your area. If you do not maintain at least the coinsurance requirement, then you might be penalized at the time of a loss. For example: You buy a property for $50,000 and ask your agent to insure if for that amount. The Actual Cash Value, however, is actually $100,000. You have an 80% coinsurance requirement. You later have a total fire loss. Since you only insured it for 50% of the ACV, then you will be penalized, and only receive 50% of the insurance limit, or $25,000. If you had insured it for $80,000, you would have received 100% of the insurance limit, or $80,000.