

## Is Replacement Cost the Right Coverage Option Amid Spiraling Costs?

The majority of homeowner's insurance policies have what's known as "replacement coverage," which will cover the costs of repairs or reconstruction to rebuild your home to its original state after a covered event.

But thanks to rising costs of construction, including materials and manpower, some of these policies' replacement coverage limits may not be enough to cover those costs. So, does that mean that replacement coverage policies are insufficient, and should you instead choose a policy that will pay you the market value of your damaged property?

Here's what you need to know:

There are typically two types of homeowner's policy coverage options:

**Replacement cost coverage.** These policies pay to repair or replace damage to your property at today's labor and construction prices without deducting for depreciation.

**Market value (or actual cash value) coverage.** These policies are based on the value of the property at its current condition and consider factors like the price of your land and depreciation.

### Getting it right

Most homeowner's policies include replacement cost coverage for your dwelling, but the limit you choose when you purchase your policy will impact how much you receive from your insurer.

This choice is especially fraught during times of high inflation, which happens to be now. [Construction costs, for example, increased 10.1% between December 2021 and December 2022](#), according to trade association, American General Contractors.

While there are many benefits to replacement cost policies, the biggest drawback is that if you don't ensure your policy limits keep up with construction cost increases, you could be left underinsured in the event of a claim.

To accurately estimate your home's replacement value, you may consider hiring a professional appraiser or contractor. With that information in hand, you can work with us and the insurer to set the replacement cost accurately.

**One thing to remember:** The higher the replacement cost, the higher your premium will be.

### Other options

If you are concerned about your policy falling short despite getting an appraisal, there are other coverage options available to you.

**Extended replacement cost:** Also known as extended dwelling coverage, this endorsement, which is added to your homeowner's policy, can increase your dwelling coverage by 25% to 50%. This can help cover higher rebuilding costs due to a surge in demand, construction material scarcity and/or high inflation.

**Guaranteed replacement cost:** This endorsement to your homeowner's policy ensures you'll be paid the full amount to rebuild your home after a disaster, regardless of how much it costs. That means if your house is destroyed by a covered event, the insurer will pay to rebuild it to the way it was before the disaster — regardless of your policy's dwelling coverage limit.

This endorsement can be pricey, but it may be worth it if you live in an area that's prone to natural catastrophes.

### **Market value coverage**

As mentioned, replacement value policies are the norm for homeowners, but some may opt for a market value (or actual cash value) policy, but it comes with risks, particularly the chance that you have less coverage than you need to repair or replace your home. That's because these policies pay the market value to replace your property, taking into account depreciation.

In other words, while a replacement coverage policy would cover the cost to buy a new sofa set to replace the one you purchased 10 years ago, a market value policy would only pay you the cost of the sofa minus a decade's worth of depreciation.

Also, one of the biggest dangers of using market value is that depending on where you live, your home may be worth less than the cost of replacing it if it is destroyed in a covered event.

These types of policies can leave you exposed and paying significantly out of pocket if you have to file a claim after a major event.

### **The takeaway**

Whether you are purchasing a new home or have one already, you should reach out to us to discuss the property so that we can help you arrive at a replacement cost level that accurately reflects construction cost realities.

Your home is likely your largest live investment and the last thing you want is to be left underinsured if it suffers major damage or is destroyed.

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