

Client Communications

Insurance to Value – Commercial Property Policies

How much insurance do I need on my building?

This is a great question, and one that our customers ask frequently.

You should have an amount of insurance that is sufficient to either rebuild your building (“replacement cost coverage”) or purchase a similar building at another location suitable for your business (“actual cash value coverage”), in the event it is totally destroyed by a fire, tornado, hurricane or other insured catastrophe.

One of the decisions you need to make when determining how much insurance to carry on your building is whether you will purchase “replacement cost coverage” or “actual cash value” coverage.

- “Replacement cost coverage” should provide enough money to rebuild your building with the same features as your current building at your current location. If there is partial loss to the building, the insurance will pay the cost of replacing or repairing the damaged property with new materials without deducting for depreciation.
- “Actual cash value coverage” will help protect your investment in the building by providing an amount of insurance based on its depreciated or market value. In the case of partial loss, the insurance will pay for the depreciated value of the damaged property, which may be less than the cost of replacing or repairing the property with new materials.

This decision will necessarily involve several considerations, including:

- Suitability – If your current building is uniquely suited to your business operations, you may need to replace it with another building comprising the same features.
- Availability – If the location of your building is key to the success of your business, you may need to build another building at the same location.

In either case, replacement cost coverage might be appropriate. If you could easily purchase a similar building in another location and continue your business there, then actual cash value coverage might be appropriate.

- Affordability – With replacement cost coverage, you will need to carry a higher amount of insurance than with actual cash value coverage. The premium for replacement cost coverage will be higher than actual cash value coverage. If the cost of your insurance is a primary concern, actual cash value may be appropriate.

The process of determining how much insurance to carry on your building – whether you ultimately decide to purchase replacement cost coverage or actual cash value coverage – begins with accurately computing the amount it would take to replace the building with the same materials and features at current construction costs, not including the value of the land. Don't think about the price you paid for your building or the appraised value. The cost of rebuilding could be more or less than the price you paid or could sell it for today.

There are several resources available to help you determine what it would cost to replace your building. Remember: Real estate values and rebuilding costs change all the time, so it's a good idea to do this annually before your policy renews.

- ✓ **Obtain a building appraisal from a qualified professional.** Ask your agent or insurance company for recommendations for or referrals to qualified commercial real estate appraisers.
- ✓ **Use the insurance company's replacement cost estimator.** Almost all major insurers offer this service. It is an automated program provided by a leading aggregator of building cost data (such as Marshall & Swift). You provide information on your building – such as square footage, type of construction and special features unique to its occupancy – to input into the computer program.
- ✓ **Use your own replacement cost estimator.** Marshall & Swift (www.marshallswift.com) offers the same automated program used by insurance companies for sale to the public.
- ✓ **Talk to a local contractor.** But keep in mind that they are usually building new buildings from “scratch.” The cost per square foot for new construction is generally less the cost to rebuild.

Besides the cost of materials and labor you normally consider when thinking about constructing a building, there are other considerations such as

- ✓ The expense of clearing debris from the site before rebuilding can begin
- ✓ Fees for an architect or other design professional to estimate costs and produce plans to be followed by the contractor
- ✓ Rapid inflation in the cost of building materials and labor following a major catastrophe that affects a number of businesses and homes in the same area
- ✓ Local building codes that require replacement with additional features or more expensive materials

Debris Removal

When repairing or rebuilding a building after a loss, you can't start the process until the

site has been cleared of the debris. This is an additional expense you wouldn't incur if you were building from scratch. All insurance policies pay for this expense, but some pay more than others.

Some policies pay debris removal expenses in full, but the payments reduce the amount of insurance available to replace the building. Other policies cover debris removal expenses only up to a certain percentage of the amount of the loss (25 percent is typical), but that payment still reduces the amount of insurance available to cover damage to the building. Most policies provide a small additional limit (as low as \$10,000) for debris removal expenses that exceed the amount of loss on the building or the percentage limitation. Higher amounts of debris removal coverage are generally available for an additional premium, so ask your agent to quote a higher limit if you think you need more.

Inflation

After a major hurricane or a tornado, building materials and construction workers are often in great demand. This can push rebuilding costs above policy limits, leaving you without enough money to cover the bill. To protect against such a situation, as well as the normal inflation in these costs during any 12-month period, consider adding a "cushion" to the amount of insurance you select.

Building codes

Local building codes are updated periodically and may have changed significantly since your building was constructed. If your building is badly damaged, the building officials in your community may require you to rebuild it to meet new building codes. Some communities require you to demolish undamaged parts of the building if they determine the damage exceeds a certain percentage of its value.

Most commercial insurance policies include the extra expense of rebuilding to code up to a certain dollar amount like \$10,000 or a certain percentage of the limit like 5 percent. Most insurance companies offer an additional limit for building code coverage for an additional premium.

To fully cover the additional costs related to required building code enforcement, you must add the necessary amount to the limit of insurance or purchase additional coverage if offered by the insurance company.

Whose Job Is It to Determine the Proper Amount of Insurance?

Ultimately it is your responsibility to establish the value of your property and select the amount of insurance for your policy. We can help with that decision and explain what you can do to avoid an unpleasant surprise after a loss.

Contact our Protection Team at KHT Insurance today!

(817) 336-2721 or (800) 814-6470