



# Circle of Safety

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**Orlando Frasca**  
 Trusted Insurance Advisor

## Replacement Cost VS. Market Value: *Insuring A Home Properly*

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Ask an insurance agent, a mortgage broker, and a realtor “How much insurance should I have on my new home” and I will guarantee you will get three different answers. The mortgage broker might say the loan amount, the realtor might say the market value, and the insurance agent if he or she is doing their job correctly will say the replacement cost of the home. So who’s correct?

In short, it has to be the replacement value. Homeowners want enough coverage to rebuild their home if a catastrophe happens. Let’s take a look at how an insurance company comes up with this number. Insurance companies utilize a computerized “replacement cost worksheet” which incorporates historical date of building costs in a given area. This data is compiled by independent companies who do actual surveys of building costs and provide it to insurance companies and others in the construction business.

One of the best known companies providing this information is Marshall & Swift. By plugging in the square footage, number of baths, style of the home, and the home’s other amenities into the worksheet a replacement value is determined. The worksheet also considers the extra cost of rebuilding a home like demolition cost, debris removal, architectural plans, and even environmental costs. The replacement value may be more or less than the home’s market value.

In a depressed home market, this value could be more than what a home sold for. The replacement value could also be more than the sales price in a distress sale. In a hot real estate market, the value could be, and usually is, less than what the home sold for. The replacement value will also be less than the market value when a sale involves a large amount of acreage. This causes a dilemma in that the mortgage company or bank wants the insurance to be equal or greater than the loan amount and the buyer doesn’t want to insure more than the replacement cost.

Many states have enacted laws stating lenders can not force insurance about the replacement cost of a home due to this problem. Keep in mind that the replacement cost worksheet works well in determining the correct amount of insurance for the average home in the average community. High valued homes with a lot of customization present a different set of challenges.