

They don't Make 'em Like That Anymore. Calculating Replacement Cost on Older Buildings.

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You found it after a year of searching. It's a church, more precisely a church building, now vacant, yet another casualty of urban flight. Built in 1860 it witnessed baptisms, weddings and funerals for generations, but for the last 40 years it held a silent vigil at its own funeral. Yet you saw its potential for revival with your dream of a trendy retail space.

So now you've agreed on the price, the paperwork is nearly done, and your lender asks for a certificate of insurance for the building. Your insurance agent is happy to help, and asks you for the value of the building. You give him the purchase price. He tells you that he needs to know the replacement cost of the building, not the purchase price. What do you say?

Property Insurance 101

In my career I've been an insurance broker and a property insurance underwriter. I've done my share of older properties. It is tricky, and requires more thought than newer buildings. But first, let's start with the basics.

Property insurance covers you for damage to your building. Underwriters need accurate replacement costs to assess their risk. What is the definition of replacement cost? It is the cost to repair or replace the building *with like kind and quality*. So, you can start to see the problem.

Insurance underwriters use valuation software like Marshall Swift Boeckh to provide replacement cost estimates. It is fine for modern construction but not on older

buildings. The building features you love about your old church can't be captured in drop down boxes on standard software. The old saying, "they don't make 'em like that anymore" makes an underwriter nervous. But, the stakes are high. Not properly valuing the building can lead to a significant financial loss should a disaster occur.

What if...

What if your church caught fire and is now a pile of smoking rubble? Not a pleasant thought but neither is thinking about insurance after the fire. Answer these two questions to help you decide how to insure your building before it burns down.

The first is "*Could* you replace your old church with like kind and quality?" This question gets at the external factors that would prevent you from replacing the church. Are the construction materials and skilled labor available? Would today's local building codes allow you to replace it exactly as it was?

The second question is "*Would* you replace it with like kind and quality?" Answer this from your heart. If you could, would you? Perhaps the economics of the deal are better with a different type of property. Perhaps the local codes would allow for a rebuild with like kind and quality but now you have to put in fire sprinklers. Or maybe hurricane impact stained glass. You get the idea. It just wouldn't be the same old church but maybe it still has appeal to you.

If you answered "yes" to both questions, then you want to buy *replacement cost coverage*. The policy wording will give you replacement cost with like kind and quality, and it would apply to the big losses, like your church burning to the ground, and the small losses, like lightning hitting the steeple. But, we are still left with those pesky underwriting questions-how do you set a replacement cost value for your beloved church?

You will need a sophisticated replacement cost appraisal from a firm that specializes in older and historical building. This is typically an on-site, brick by brick assessment. It takes time and is expensive, and the resulting replacement cost value is guaranteed to be a jaw-dropper. I once insured a schedule of older churches and the appraisal came in

with a replacement cost of nearly \$1,000 per square foot. They just don't make 'em like that anymore.

The good news is that an appraisal will allow the insurance company to waive the provision in the policy that could reduce your insurance recovery. It is called a *coinsurance clause* and underwriters use it to encourage you to insure to full value. The waiver is called an *agreed amount endorsement*. This endorsement is critical to get to get your maximum recovery.

You should also know that replacement cost does not cover the cost of improvements to the new church to comply with new building laws. So, your new sprinklers and hurricane impact stained glass will not be included because they are not "like kind and quality". However, for an additional premium, you can buy an endorsement called *Building Law and Ordinance*". It provides insurance for the additional costs to comply with building codes.

Plan B...

So, by now you are thinking that the old church has seen its best days, and maybe something newer at that spot wouldn't be so bad after all. What are your choices? First, decide what that a new building of the same square footage would cost, using today's construction methods and materials. You can then approach your insurance company and ask for *Functional Replacement Cost* coverage. This coverage gives you the money to replace your older church with a new building of the same size and function, using today's construction materials. The advantage to this approach is that it would substantially reduce the amount value you needed to insure, and so reduce your premium.

The disadvantage is on small losses. How would Functional Replacement Cost work in repairing a small loss? The same principle applies. You would get the cost to repair or replace the damaged property with functionally equivalent materials. For example, older properties with mahogany woodwork or plaster walls could be replaced with pine and wallboard. You may need to pay out of pocket for the higher quality materials.

Don't despair...

Insurance is complex, and older buildings are a challenge, but don't despair. There are many good resources to help you. I'd recommend the following:

- Think about worse case scenarios. What if the building burned down, or were flooded? What would you want to do? What would the building codes allow you to do?
- Use an insurance agent that understands older buildings. They should have access to high quality insurance companies have expertise in older, historical buildings. They can provide a wealth of good information and competitive policies;
- Find an insurance product that most closely meets your need at a price you are willing to pay.

So, with a bit of planning, a good insurance agent, and a quality insurance company you can sleep easy. And so can your church.