Buy or Rebuild? FAQs on replacing a dwelling after a total loss

This publication provides guidance to disaster-impacted property owners who want to buy a replacement home instead of rebuilding the one they lost. This option works well for survivors who don't want to undertake a major construction project after losing their home or who want to move out of the area where the traumatic event occurred. It's also a good option for those who want to downsize but still maximize their available insurance benefits.

Traditionally, after a loss, you had to rebuild a like kind and quality home at the original location in order to collect all available benefits under your insurance policy, although insurers in some situations have been willing to negotiate and allow a purchase instead of a rebuild. Some have then insisted on deducting land value from what they will pay toward the replacement dwelling purchase price.

Thanks in part to UP's work, there is a growing trend in wildfire-prone states to allow disaster-impacted homeowners to replace their dwelling as they choose without leaving insurance money on the table.

There is now a statute in California that gives disaster survivors who buy a replacement home the right to collect the full amount of insurance benefits that would have been available if they rebuilt, and the Colorado legislature has enacted a similar law. (CA Ins. Code 2051.5(c), CO HB22-1111) Those factors, plus logic and math, give you leverage to negotiate with your insurer.

The main thing to focus on is reaching an agreement with your insurance company on what it would theoretically cost if you did rebuild the exact same home that was destroyed. This cost should include all trades, fees, materials, labor and work required to comply with building codes, construction standards and permitting rules in the area. Once you reach an agreement on that theoretical cost, you can work toward a fair insurance settlement that will allow you to collect the full amount of benefits that are available in your policy, and use that to buy a new home instead of rebuilding.

United Policyholders encourages you to use all available arguments to convince your insurer that they should allow you to use your paid-for benefits to replace your home as you choose. In our view, it is not ***reasonable*** for an insurer to deduct land value or withhold coverage for extended benefits or code upgrades from your settlement toward the purchase.

What is “Replacement Cost Value Coverage” (RCV)?

RCV Coverage is the dollar amount it would cost to replace or repair your home with one of like kind and quality to what you lost. Depreciation does not apply to an RCV calculation.

What is “Actual Cash Value Coverage” (ACV)?

ACV is the Fair Market Value of your home on the day before the loss (what a willing buyer would have paid a willing seller). Your policy may have a different definition; a common one is that ACV equals the RCV minus depreciation. ACV is typically lower than RCV due to depreciation.

What is “Building Code” Coverage?

Building Code Coverage is a policy benefit you may or may not have that pays for work and materials that will bring your home into compliance with the construction codes/ordinances in your area. If you have this coverage, it will cover some or all of those improvements. If you don’t have this benefit, your insurer will not cover the cost of building code-related improvements because they consider that to be excluded as “betterment.”

What is Extended Replacement Cost Coverage (ERC)?

Extended Replacement Cost Coverage is a feature that gives you extra coverage above your dwelling limit if you suffer a loss above that limit. It’s usually provided through a “rider” or “endorsement” you paid extra for. The most common ERC comes in amounts of 25, 50, 75 or 100% above your dwelling limit.

When does the insurer pay ACV instead of RCV?

Typically, when rebuilding on the same lot, your insurance company will pay ACV after they have calculated the cost to rebuild, but before the work to rebuild has actually been done. They will pay more as they get proof that work has been completed. Generally, the insurer pays only ACV until progress has been made toward replacing or repairing the asset.

When will the insurer pay full RCV benefits toward the purchase of a replacement home?

Your insurer should pay you the amount of the theoretical cost of rebuilding your home at the original location (including code upgrades and extended coverage if you have those benefits) as soon as you and they agree on that cost and you've given them proof of the purchase price of a home you want to buy. Generally, your insurer will want evidence that you are replacing the dwelling and spending at least what it would have cost to rebuild before they'll release your full benefits toward the purchase.

To receive ALL available benefits, the cost of the new home must be equal to or more than the theoretical cost to rebuild your home at the original location (RCV). If your benefits are not enough to cover the home you want to buy, you can add your own money, but your insurer will only pay up to policy limits.

Can I buy a house for less money than my full extended cost replacement value and pocket the difference?

Generally no, unless your insurer gives you a cash-out settlement with no strings attached.

If I buy instead of rebuild, can insurers deduct from my replacement cost settlement an amount it determines to be the value of the land of my new home?

This isn't allowed in California or Colorado, but in other states you can make the following arguments:

1. If the policy doesn't authorize a land value deduction, the insurer is not entitled to take one;
2. Land values are subjective. Why should the insurance company be entitled to its number?
3. If you buy a new home plus the land it sits on for the same amount you'd have to spend to rebuild your own home, it stands to reason that you would be buying a home that is lesser in value than the costs of replacing your own home.
4. The simplest approach is for your insurer to pay you the full amount, up to your policy limits including all extensions that you would have to spend to rebuild your destroyed home. This assumes that you have provided a reasonable scope of loss as well as proof of your intent to actually buy a different home.

5. Moving to a lower wildfire risk region is “win-win.”

Do I need to present the insurance company with a SCOPE OF LOSS and estimate of what I lost AND the price of the home I want to buy?

We recommend doing both. Your insurance company has the legal obligation to investigate and value the damage to your property and fairly pay your claim. However, because your home is your valuable asset, it’s in your best interest to verify that their valuation is accurate. For verification, we recommend getting a detailed scope of loss prepared by a trustworthy professional with construction estimating expertise to help you determine what your home would *theoretically* cost *if you did* rebuild the exact same home that was destroyed. Generally speaking, that is what the insurer owes you.