

[The Replacement Cost Reality Check: When Home Insurance Safety Nets Fall Short](#)

Bankrate

On a crisp October day, Gershon and her husband were clearing limbs and burning leaves — a routine fall chore across the Northeast. They weren't reckless, says Gershon. "We're the people who look up the county codes ahead of time. Is there a certain time of year? Does it have to be a specific distance from the house? What does the ground need to be like?"

As they worked, a small fire scorched the side of their home, which they were able to put out quickly. At first, the damage appeared minimal. But after extinguishing the flames, they looked up and saw smoke billowing from the chimney.

The fire chief called it a "freak accident." Somehow, embers had gotten caught between the vinyl siding and sheathing of the house, spreading the fire across the attic.

Gershon and her husband were able to get their two young children to safety, but in the weeks that followed, they faced a different kind of challenge: a massive chasm between their insurance policy's promises and the reality of rebuilding.

When coverage and costs diverge

After the fire, Gershon and her husband began the process of compiling estimates to rebuild her home. The local fire department estimated the damage at roughly \$750,000. An architect's feasibility study estimated a rebuild cost between \$600,000 and \$900,000. The insurance company's number? Approximately \$258,000 in actual cash value, with a replacement cost value in the low \$300,000s.

For Gershon, the discrepancy was jarring. Her homeowners insurance policy listed \$500,000 in dwelling

coverage and a 25% extended coverage endorsement.

Seeking clarity, the Gershons hired a seasoned restoration contractor — a former insurance agent with decades of experience. His initial estimate for the basement, first floor, roof and exterior totaled about \$383,000. But because his estimate excluded the second floor, screened-in porch and landscaping, that sum still wouldn't fully restore the home to its pre-loss condition.

As of this writing, Gerson's claim remains ongoing — and it's possible these valuations may shift as the process continues. But the question remains: How can discrepancies on this scale emerge, even when homeowners believe they've done everything right?

"When you look at the policy, it feels like the coverage is there," she says. "But then you get a number that doesn't reflect what it actually costs to rebuild, and it just doesn't make sense.

How replacement cost coverage can go wrong

In situations like the Gershons', coverage conflicts can arise from a combination of factors — from differences in rebuild estimates to policy limitations, valuation methods and claim procedures.

Insurers control the claims process — and the language of the policy itself — creating an inherent power imbalance between the company and the policyholder. Homeowners who receive less than they believe their policy promises can feel like the carrier is being dishonest or that they're operating in bad faith.

However, the legal standard for bad faith is much higher than a simple dispute over a claim payment. Courts generally look for evidence that the insurer intentionally or recklessly failed to investigate, communicate or settle a claim fairly.

Gershon isn't ready to say the situation has reached that point yet, and says she's surprised by how quickly people suggest bringing in outside help. "People kept telling us to get a lawyer or a public adjuster," Gershon says. "And I kept thinking, why should I have to hire someone just to enforce a legally binding contract? That shouldn't be the first step homeowners feel they have to take just to get their insurer to do what the policy says."

While bad faith requires clear evidence of unfair conduct, many disputes arise from more complicated forces. Challenges with estimating software, rising construction costs, depreciation holdbacks and confusing rebuild estimates can all contribute to gaps between what a homeowner expects and what an insurer initially pays.

Generic estimating software and inflation leave homeowners underinsured

Many policies rely on an inflation guard endorsement to help prevent coverage limits from lagging behind construction inflation. “It automatically increases a homeowner’s dwelling and personal property limits annually to keep pace with rising construction material and labor costs,” says Mark Friedlander, senior director of media relations for the Insurance Information Institute. “This protects against underinsurance and ensures the policyholder has adequate replacement cost coverage for repairing or rebuilding their home following a covered loss.”

But construction costs have been anything but predictable over the past several years. While inflation peaked at 9.1% in June 2022, construction costs are still volatile. Prices for residential building materials and labor rose sharply between 2020 and 2022; in some cases, far outpacing the average 2% to 4% annual inflation guard adjustment.

...