

Replacement Value & Functional Replacement Value

Buildings

Clients under most circumstances can insure their buildings for their replacement value (RV). Cover is described in the Reinstatement Memorandum in the policy. Briefly, it allows for the replacement of the insured structure on a *new for old* basis, without any form of depreciation being applied. Functional Replacement Value (FRV) follows the same process, but the valuation recognises that the client only needs a smaller structure to replace “functionally” what currently exists, to meet their future requirements. For example, the client may only wish to replace an existing church with a smaller building to represent the changing needs of the church and congregation.

As both options form a basis of replacement cover, insurers require a valuation from an approved valuer/quantity surveyor to determine the correct amount to be insured. Insurers expect valuations to be supplied at least every three years (unless there are material changes), with desk top updates during intervening years. If a client requires functional replacement cover, the valuation must include not only the functional amount to be insured, but also the replacement value of the existing structure. The reason for this is that the existing structure *footprint*, is still the exposure to insurers for damage. Insurers initially rate the premium on the replacement sum insured of the existing structure, and then discount the premium by the amount of functional replacement cover required by the client. The discount given by insurers is *not proportional* to the difference in values between RV and FRV. The discount on a difference of 25% between RV and FRV may only be 10%. The reason for this, is that most damage requires repair or restoration to the existing structure, and the premium pool needs to remain high enough to fund these types of losses. With FRV, the reduction in sum insured comes from the top end of insured value, and only applies in the event of a total loss.

While FRV may appear to be attractive option for churches where they do not require the same footprint for a complete rebuild, the most likely case, is that damage is such that the church can be repaired/restored. Valuations are based on a *green fields* approach where the cost to build per m² is a lot less than the cost to repair. In the Christchurch earthquakes it was not uncommon to find repair costs 5 times higher than new build costs, especially when heritage features had to be considered. Based on this, it could be possible to only have 20-30% damage before the replacement sum insured is exhausted e.g., new build cost \$1000m² and repair/restoration \$3000m² -\$5000m². Arguably, if this scenario was to apply then the client would demolish the building and replace the building with a new structure, even though the damage could otherwise be repairable.

However, Concordia experience is that when a building is only partially damaged the congregation might want it repaired. That is because they are emotionally attached to the building because worship, celebrations of baptism, weddings, and funerals etc. If the building was also a heritage building, then the regulator could also put pressure on to restore the building back to its heritage nature. Therefore, if the church had a change of mind, or there was intervention from the heritage regulator and the insured value was only FRV, depending on the extent of damage, there would likely be an insurance shortfall, which would delay the restoration.

It is for this reason that Concordia stipulate that the FRV figure should be no less than 75% of the new build RV. This hopefully ensures that enough funds are still available for reasonably sized restoration costs, at a much higher cost per m² than a new build cost.

Concordia will consider insuring with lower FRV sums insured, but for the reasons outlined above, clients need to ensure the sum insured remains sufficient for major repair or restoration.

Contents

Contents should be insured for their replacement value. Alternatively, they can be insured for indemnity value, in which case settlements would be made considering the age and condition of the contents claimed. If the church has a pipe organ it should be professionally valued. Functional replacement value insurance predominantly only applies to buildings.

Functional Replacement Value v Agreed Value

Essentially, functional replacement value and agreed value are the same. Functional replacement value is a form of replacement value and the Reinstatement Memorandum in the policy applies in the same way, just to a lesser sum insured. Agreed value has no definition in the policy, its simply often a heading used in the schedule of declared values to form the basis of a sum insured. if agreed value is used in relation to contents, it still needs to represent the full sum insured (representing either replacement or indemnity value) at risk at any given location.