



Understanding Your Property Insurance: ACV and Replacement Cost Coverage

By Marshall Gilinsky, Esq.

Your property insurance policy covers the cost “to repair or replace damaged property with property of like kind and quality.” But if a fire destroys your hotel, your insurance company might refuse to pay the cost to replace it.

I. ACV vs. Replacement Cost

Historically, insurance generally did not cover the full cost necessary to replace damaged property since doing so violated the principle of indemnity by putting the policyholder in a better position by providing new property in place of old. Accordingly, depreciation generally was deducted during the adjustment of losses covered under Actual Cash Value (“ACV”) insurance policies. Because many policyholders preferred insurance that provided complete coverage from a loss, insurance companies began offering Replacement Cost coverage. This innovation expanded the basic ACV coverage and meant that policyholders who had a loss did not need to bear any cost in replacing depreciated property.

II. ACV Holdback

Under many policies, Replacement Cost coverage does not kick in until the damaged property is actually replaced, and insurance companies typically withhold depreciation until the property is actually replaced. The depreciation “held back” should be kept to a minimum. Doing so leaves fewer points open for discussion or to develop into problems. Moreover funds that are withheld are not available to assist in the policyholder’s recovery. Sometimes the insurance company and policyholder will agree to a “walk-away” settlement for figure that is somewhere between ACV and Replacement Cost. This can be a win-win situation, with the insurance company paying less than the full replacement cost owed, and the policyholder getting most (if not all) of its money up-front, as well as the choice not to replace certain property and use the money on types of property not owned at the time of the loss.

III. Replacing Elsewhere or with Non-Identical Property

Many policyholders believe – incorrectly – that they must restore the property to its exact condition prior to the loss or replace the property with exactly the same property. Generally, as long as the replacement dollars are spent, the depreciation will be recoverable, but the amount of the claim will be determined based on the cost to replace the property that actually suffered the loss.

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