Replacement Cost Value: A New Rating Variable for Risk Rating 2.0

For those familiar with the legacy rating system (RR 1.0), Replacement Cost Value (RCV) was not used as a rating variable, except in specific situations like Zone V or residential condominiums. Under the new Risk Rating 2.0 pricing methodology (RR 2.0), it is one of the key variables…and is another way FEMA is trying to make the new rates more representative of an individual building's flood risk compared to RR 1.0.

Why replacement cost?
Basically, with everything else being equal, larger more expensive buildings will typically cost more to repair after a flood than smaller, less expensive buildings. Take for example, the two homes in Figure 1 whose flood zone and elevations are the same – a 4,000 square foot home with a replacement cost value (RCV) of $1 million and a home next to it that is 1,400 square feet with a $200,000 RCV. In RR 1.0, those would be rated the same, even though a foot of water in the larger home would result in more damage than a foot of water in the smaller home. In RR 2.0, the larger, more expensive home, will now have a higher rate due to the greater cost to replace the structure in case of flood damage.

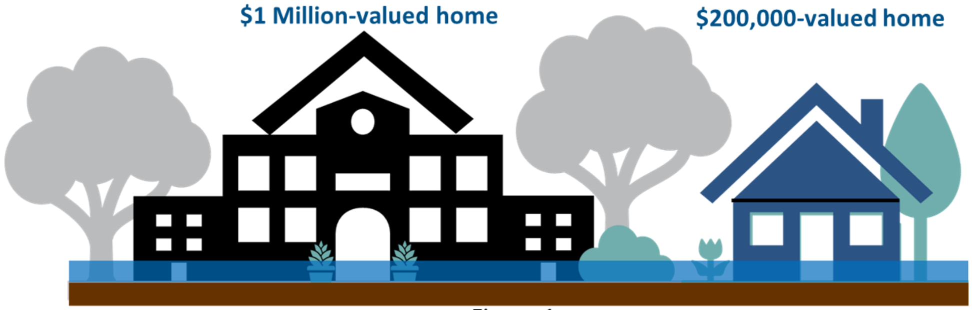

Figure 1.

How is replacement cost determined?
The building's RCV will be determined by RR 2.0 using the CoreLogic RCV Tool for specific building types: single-family homes, residential manufactured/mobile homes, residential units, and two-to-four family buildings. If FEMA is unable to determine the building's RCV—and for all other occupancy types[1] —the agent or insurer must obtain RCV based on appraisal methods commonly used in the insurance industry and report it on the application form. Note that FEMA will reassess its determination of RCV at every renewal.

Can buildings with higher RCV get more coverage?
The RCV used for rating has no bearing on the amount of coverage a policyholder can select. However, they are still limited to the same statutory limits as in RR 1.0 (e.g., $250,000 for single-family dwelling). Note that if a policyholder selects building coverage above the RCV determined by RR 2.0 or provided by the insurer/agent (but no higher than the maximum coverage limits), then the building coverage amount selected by the policyholder will be used as RCV.

5 Key Factors Impacting RCV

- Property zip code
- Year built
- Square footage
- Number of floors
- Number of units

What if the property owner disagrees with the RR 2.0-generated RCV?
Unfortunately, the RCV generated by RR 2.0 cannot be appealed or changed. However, a policyholder can verify that their agent has accurate information on the five key factors impacting the RCV. In addition, as mentioned, if it is felt the RCV is too low, the property owner can choose higher coverage, up to the NFIP maximum amount. Again, if the RCV is less than the coverage selected, then the RCV will increase to match the coverage limit.

Can RCV be used to make Substantial Damage (SD) determinations for floodplain management?
Because RCV is not the same as market value, it cannot be used for making SD determinations in floodplain management. There will be no changes to the SD determination process as a result of the RCV variable or the new pricing methodology.

For more details about RCV, read Section 3.II.C.7 in the October 2021 RR 2.0 Flood Insurance Manual

Understanding the Terms

Replacement Cost Value (RCV) – The cost to replace property with the same kind of material and construction without deduction for depreciation. The building replacement cost value is the cost to replace the building or unit, including, for a building, the cost of the foundation.

Actual Cash Value (ACV) – The cost to replace an insured item of property at the time of loss, less the value of its physical depreciation.

Market Value - The price that the seller is willing to accept, and the buyer is to pay on the open market and in an arm's length transaction. (For the purposes of determining substantial improvement, market value pertains only to the structure in question.)

Substantial Damage – A structure in a Special Flood Hazard Area (SFHA) for which the total cost of the repairs is 50% or more of the structure's market value before the disaster occurred, regardless of the cause of damage.

[1] Residential Condo Building, Other Residential, Non-Residential Building, Non-Residential Unit, Non- Residential Mobile/Manufactured Building