TOPIC: HOMEOWNER'S INSURANCE

Most American homeowners view their house as their single most valuable asset, and recognize the importance of purchasing insurance to protect it. Yet many homeowners have only a passing familiarity with the way most homeowner insurance policies are structured. The purposes of this paper are to describe the basic features of homeowner insurance policies, consider how these policies can be adjusted to suit an individual's needs, and to discuss separate policies which cover losses excluded from standard homeowner policies.

The Parts Of A Homeowner's Insurance Contract

All homeowner policies are divided into two sections: Section I, which covers damage to the house, and Section II, which covers liability losses. Section I is divided into four parts. Coverage A insures the house and structures attached to it. Coverage B insures structures which are on the property but set apart from the house, such as sheds and detached garages. Coverage C insures personal property owned or used by the insured. Coverage D provides loss-of-use coverage, which includes the costs of living elsewhere when the insured house has been made uninhabitable.

The liability coverage of Section II is divided into Coverage E, which is a form of personal liability coverage, and Coverage F, which insures against the medical expenses incurred by those injured on the insured property. All Coverages, A through F, have itemized limits for losses beyond which the insurance company is not responsible. Naturally, higher loss limits cost more money.

Types of Coverage

When purchasing any insurance policy, a primary question is: what is covered and what is not? There are three basic types of Section I coverage. "Basic" coverage includes damage caused by things such as theft, vandalism, fire, smoke, lightning, wind, and cars and planes. "Broad" coverage adds seven additional perils, including ice, snow, and sleet, and damage to the water, heating and air conditioning systems, and domestic appliances. The most liberal and most common type of homeowners insurance is written as "Open" Coverage, which includes all perils not specifically excluded in the insurance contract. When comparing bids from insurance providers, the only way to know whether one company is charging more or less than another is to make sure that similar types of coverage are being evaluated.

Earthquake is a peril generally not included in Open Coverage. Due to the potential for catastrophic losses resulting from a major earthquake, most insurers in the state of California are no longer willing to cover losses resulting from earth movement. A government-created entity, the California Earthquake Authority (CEA), now sells most of the earthquake policies in the state. The high premiums charged by the CEA have been criticized by some, who note that the standard deductible of these policies, typically 10% and 15% of a home's replacement cost, means that many homeowners will go tens of thousands of dollars out of pocket before losses begin to be reimbursed. Be that as it may, choosing not to purchase earthquake coverage exposes the homeowner to potentially enormous home reconstruction costs.

Damage caused by flood is another exclusion in most homeowner insurance policies. Many different insurers do sell flood insurance for a separate fee. Those who live in flood plains are wise to buy it.

How Much Is Enough?

Homeowners should buy only as much insurance as is necessary to cover the cost of rebuilding their home in the event of a total loss. This amount is typically far less than the market value of the home. Even in the case of a devastating fire, for example, a garden or yard will not likely suffer significant damage, and the foundation of the house can typically be reused. Many insurers recommend that 80% of a home's replacement cost is an appropriate figure to target for insurance.

There are some who are under-insured as well. This condition is more prevalent among those who purchased homes long ago and have not raised their level of insurance to keep up with inflation. Adding an inflation guard to an insurance policy is a good idea for those who don't want to review their policies every several years. Those who have added to or improved their homes may also wish to reflect a home's higher replacement cost with higher insurance limits.

Insuring Your House's Contents

Making sure that valuable personal property is adequately covered is another important consideration. Many insurance companies recommend that Coverage C for personal property roughly equate to 50% of Coverage A (house and attached structures), and in many cases this may be quite appropriate. For those with rooms full of antique furniture, however, increasing Coverage C to a higher percentage of the Coverage A limit is prudent. Homeowners with particularly valuable items are wise to maintain photos and recent appraisals of such items, since insurance companies will likely resist large and unsubstantiated claims. It is also important to understand whether the contents of your house are covered at their depreciated worth, or at their replacement cost. Replacement coverage costs more, but more accurately reflects what most insureds expect their coverage to fund.

Most home insurance policies limit losses on items such as jewelry and furs to no more than $1,000 or $2,000 per item. Items valued well above these limits need to be covered under separate policies, referred to as "floaters."

Choosing An Appropriate Deductible

Homeowners should purchase only that amount of coverage which exceeds losses they are willing to bear. This means that for most individuals, relatively high deductibles are appropriate. Small losses are annoying, but insurance policies that carry higher deductibles are generally less costly over time.

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