

Buying Homeowner's Insurance

by David E. Young

Buying homeowners insurance is one of the most important financial decisions a family can make. However, it is also an area in which many people lose by default. Many people do not know how much insurance is placed on their home, nor do they know who their homeowners' insurance company is. The purpose of this article is to encourage you to ask questions during the buying process so that you can make informed insurance decisions.

Before deciding on a homeowners' policy, first put yourself in the proper frame of mind. Close your eyes and imagine that a fire has devastated your home and nothing is left, as unpleasant as that might be. Now, ask this most important question: *How much protection would I need in order to rebuild my home and replace everything I lost?*

How much insurance should I buy?

The first decision you must make when shopping for homeowners insurance is the amount of insurance to carry on your home. How much is adequate? To repair your home after a loss will require money to pay for contractors and materials at *today's prices*, not what was paid when you bought your home years ago, or your home's value today. How much will it take to build your home *just as it is now?*

Some mortgage companies will require that you insure your home for at least your loan amount. If your lender arranges for the policy that gets placed on your home, most likely it will only insure you for the amount of the loan - **not** the amount it might cost to rebuild your home.

DO NOT let your mortgage company choose your insurance carrier or your policy limits. The mortgage company's interests are not the same as yours. The lender only cares about protecting its loan amount. You need to protect your home and yourself. I cannot express the heartache I have seen when homeowners have discovered their mortgage companies have placed insurance on their property to

cover the structure only with no contents or additional living expense coverage. Get involved in the process- try to buy “extended coverage” or even better – **guaranteed replacement cost coverage** (more on this later) plus contents and ALE coverage.

How much should my deductible be?

A deductible is the amount of a potential loss that YOU are responsible for paying. . Your insurance company covers the balance. Deductibles on homeowners’ policies affect the cost of those policies. The higher the deductible, the lower the premium. Raising your deductible is a good way of bringing down the cost of your insurance.

We generally recommend that homeowners buy policies with a higher deductible, but not only because premiums will be less. Generally, higher deductibles result in a better “loss ratio” on the records of an insurance company. If you insure the first \$500 (or even \$1,000) of a loss, you will be less likely to have an insurance company keeping your loss as a statistic than if your deductible was \$250. The reason for this is simple: you won’t be turning in claims for these smaller amounts.

Our office adjusted a \$750,000 loss. The insurance company’s attorney told us that the claim could be denied because the insured, in the application for the policy that covered the loss, had failed to disclose several small prior losses. The attorney implied that there was some deception in obtaining the policy. The failure of the insured to identify those losses in the application was just an oversight because the losses were so small. Had the insured obtained a policy with a higher deductible, these small claims might never have been submitted.

That being said, State Farm has a new program that computes deductibles based upon a percentage of the policy limit. This could make the deductible many thousands of dollars. We have adjusted claims for insureds who, for some reason or another, did not understand this, and they (and their contractors) became angry when they discovered how much would be withheld from their claim for the deductible. Someone I trust who works for State Farm told me that the program was instituted so that State Farm could remain competitive in its premiums.

The point to take away here is: *make sure you know the amount of your deductible before you have to submit a claim.*

What insurance company should I purchase my policy from?

It is very important to weigh all your options before deciding which insurance company to purchase insurance from. We can no longer recommend a particular insurance company based on our adjusting experience, however, we might suggest some issues that you should consider.

An insurer may be a “direct writer” or “non-direct writer”. A “direct writer” is a company whose own agents write the company’s policies. Such insurers include Allstate, Farmers, and State Farm. These companies are much more responsible for their employees than insurers that contract outside agents, or “non-direct writers”. Our office recently adjusted a loss in which there was a coverage dispute. The insurance company’s adjuster recommended that we “sue the agent,” and walked away. That probably would not happen if your carrier were also the employer of the agent. However, there are no hard and fast rules here—of course, non-direct writers can be responsible for their agents as well.

An argument could be made that if someone’s home and auto were both destroyed at the same time, then the auto rental coverage could be provided under the Additional Living Expense portion of the policy IF a homeowner had his/her homeowners and auto insurance policies with the same direct writer. This argument may be valid. If this argument were accepted, this would be another reason to obtain all of your insurance with the same direct writer.

We have a concern with State Farm policies. State Farm started changing its policies a while back, but we started seeing the impact of these new policies several years ago. The policy is revolutionary, and that may not bode well for the consumer. For example, most policies have a provision for replacement with “like, kind and quality”, while State Farm provides for “comparable construction”.

Even though the above arguments for a “direct writer” insurance company are obvious, does that mean you should not buy policies from insurers who are not direct writers? *Not necessarily.* Most adjusters for the insured will tell you that the fairest insurers are those whose company’s policies are written by independent agents who are not direct writers (such as Chubb Insurance.)

Who should I select as my agent?

Keep in mind that an agent’s primary responsibility is to sell policies. Once the claims department receives your claim, your agent will be no more than an observer, especially on larger claims.

You should use the same care to choose an agent that you would use to choose an accountant or an attorney. Be certain your agent is competent. Ask him or her to explain some things and then analyze their response. If the agent does not answer to your satisfaction, consult a different agent.

Find an agent who will return phone calls promptly, even over the weekend. If you have a loss on Saturday, and your agent can't get it into your insurer until Monday, what will you do for those two days, especially if there is no "hotline"?

When you receive your homeowners' policy, we recommend that you ask your agent to send you a letter that states, "If your home was totally destroyed, your coverage is adequate to rebuild it completely." If a dispute should arise later, this letter might support your claim.

What type of policy should I buy?

HO-1 (Basic fire policy): This policy covers the dwelling, other structures such as garages, and personal property against fire, lightning, vandalism, malicious mischief, theft, and glass breakage. Loss of use and additional coverages are also included in all of the homeowners' forms.

HO-2 (Broad): This policy covers the perils of HO-1 plus falling objects; the weight of ice, snow, or sleet; accidental discharge from a plumbing, heating, air conditioning or sprinkler system or household appliance (water from flood is excluded); tearing, cracking, burning, or bulging of a steam or hot water heating system; freezing of plumbing; heating, air conditioning or sprinkler system or a household appliance; damage from artificially generated electricity; and volcanic eruption. Coverage for a number of the HO-1 perils (vehicles, smoke, and glass breakage) is broadened in this form.

HO-3 (Special): This policy covers the dwelling and other structures on an all-risk perils basis. Personal property coverage includes the broad named perils insured under form HO-2, plus the peril of damage by glass or safety glazing material. Coverage on personal property may be added by attaching a separate endorsement.

The type of policy that is generally best for a homeowner is classified as an **HO-3 or HO-5**. Study the differences in the major types of homeowners policies listed below.

HO-4 (Broad Coverage for Contents): This policy is designed primarily for tenants, and covers

personal property and limited coverage for building additions, alterations, and improvements made by the insured. The named perils coverage on personal property is the same as that of HO-2.

HO-5 (Special): This policy is similar to the HO-3 policy but covers the replacement cost of structures, without deduction for depreciation, and offers structure payments in excess of policy limits. This coverage is greater and the policy is generally better than an HO-3 policy.

HO-6 (For Condominium Unit Owners): This policy is especially for residential condominium unit owners.

HO-8 (Modified Coverage): This policy is for homes not considered eligible for replacement cost coverage.

Should I add endorsements and additions to my insurance policy?

An *endorsement* (also known as a *rider*) is a form attached to the policy that changes the language of the policy to fit special situations. Some endorsements may be automatically added by an insurer to the policy you select. Other endorsements may be available for some types of policies and not for others. Ask your agent about what is available.

Ask about Code Upgrade coverage that will cover the cost of complying with building codes put into place after the home was originally built. Local and state building codes and ordinances change over time. When you are repairing or replacing damaged property after a loss, you will have to comply with these laws by making upgrades or improvements to your property. Typical items are electrical, plumbing and foundations. In insurance lingo – these are considered “betterment” because they make your property better than it was. Because policies generally exclude “betterment”, you will have to pay for these required improvements out of pocket, *unless* you have bought “Code Upgrade (sometimes called “Building Code and Ordinance Compliance” coverage. This added coverage is generally not expensive.

If you have jewelry, artworks, and other valuables, add insurance for these. Some policies cover payment of public insurance adjuster fees; if such an addition is available, request it. If any such endorsements are available, the insurer must feel that the premiums or investment of premiums for that endorsement will offset losses or extension of losses that might occur as a result of the additional coverage.

You should make sure you have replacement cost coverage (RCV) on every item insured under your policy. Guaranteed replacement cost is an addition to RCV that extends protection to include costs on your structure that are higher than the stated limits! We recommend that homeowners also obtain contents RCV. Some companies feature a policy that covers replacement costs for contents, without deduction for depreciation. Such coverage might even be considered as prepaid depreciation insurance because an item need not be replaced to recover its depreciation.

Whose name should the policy be under?

Generally, the policy of insurance obtained on a property should be in the name of the property owner, so *why should this question be asked at all?*

For various reasons, people live with other people. Sometimes these people are of the opposite sex and could be considered as common law marriage partners if they lived together in a state that recognized such a thing. However, depending upon the policy, your insurance company may or may not see it that way. Whose property is insured and whose is not? Consider including the names of **both** parties on the Declaration of Coverage sheet of your policy. The policy might then read John Doe and Sally Roe. If you are so inclined, ask your agent to do this for you.

Making a decision to purchase homeowners insurance is a big deal. Don't take it lightly—make sure you research all your options and find the policy that works best for you, your family, your property, and your financial situation.

These buying tips were written by David E. Young and edited by UP staff. David is a Certified and Senior Professional Public Adjuster with the firm of Brown & O'Haver in Mesa, AZ. The tips are based on years of experience with different types of policies and how they perform when "road tested" during the claim process. To read United Policyholders' buying tips, visit the Buying Tips section of www.uphelp.org