Do you have enough homeowner’s insurance?

http://www.signonsandiego.com/news/2011/jan/08/intricacies-homeowner-insurance/

As a public service to residents, the Financial Planning Association of San Diego is answering financial questions for readers of The San Diego Union-Tribune. Today’s question is answered by Lynn Buchholz, CFP, president of Buchholz Financial Planning who teaches the “Fundamentals of Insurance” class in the SDSU Executive Education Program

Q: My question is with regard to homeowner’s insurance. Since real estate values are down, should I lower my homeowner insurance amount? Also, should I buy earthquake insurance?

A: You ask two very important questions when it comes to property insurance.

First, let us look at the question about homeowner’s insurance. The amount of insurance that you buy for your home should not be confused with the real estate value of your home. Depending on when you bought your home, median prices have been significantly up and down since 2000, peaking in the year 2006.

Instead of selecting coverage based on the resale value of your house, the right amount of insurance is a limit set that accurately reflects what it would cost to rebuild your home in the event that it is destroyed.

Many homeowners rely on their agent to calculate the replacement cost of their home using a computer program designed for that purpose, but they shouldn’t rely on that estimate alone. Courts have backed up insurance companies in saying that it is the homeowners’ responsibility to make sure the contract they sign has adequate replacement limits. So, look to construction costs in your community for guidance.

A builder who knows your neighborhood and the features of your home can give you a rebuilding estimate on a cost-per-square-foot basis. If, for example, the features in your home would average to $250 a square foot to replace, and your home is 2,000 square feet, you would need to have a dwelling limit “Coverage A”) of at least $500,000 in order to rebuild your home. It is wise to take this extra step to make sure that you are not underinsured, should a disaster happen.

United Policyholders, a group dedicated to educating the public on insurance issues, conducted a survey of hundreds of individuals whose homes had been partially or totally destroyed from the 2007 wildfires in and around San Diego County. The results revealed that two years after the fires, 66 percent of respondents reported being underinsured, at a staggering average amount of $319,500.

So, if you have not dusted off your homeowners’ insurance policy for a while, get reacquainted with it in the new year and be sure that you understand what you are paying for with your premium dollars.

While you are reviewing your policy limits, evaluate the deductible that you chose. Most insurers allow you to increase the deductible in exchange for a lower premium. Increasing your deductible from $250 to $1,000 can reduce your premiums by as much as 25 percent and will prevent you from filing small claims that could cause an insurance company to drop you.

Your second question is about earthquake insurance, and the decision to buy such coverage very much depends on your personal financial situation and not what your neighbor thinks. Only approximately 12 percent of California homeowners have earthquake insurance. Many people still mistakenly believe that their homeowners’ insurance will help pay for their home to be rebuilt in the event of an earthquake.

Homeowners’ insurance specifically excludes earthquake insurance, and you have to make a choice to buy it. Premiums are linked to many factors including how close a home is to a fault line, the age of the home, the type of construction and the underlying insured value of the dwelling. The easiest way to find out what premiums would be for your home is to go the website earthquakeauthority.com. It provides a premium calculator by which you can determine how much the premium would be if you were to buy a California Earthquake Authority CEA) policy from your homeowners insurance company.

Non-CEA policies are also available — they usually will be more expensive but will offer higher limits and additional coverage. Some complaints about earthquake policies include “the deductible is too high.” While policies typically have a 10 percent or 15 percent deductible, if you have no coverage, that means that you have a 100 percent deductible … you’ll bear the entire risk yourself.

If your home represents a large portion of your net worth, buying the extra insurance coverage is going to do what insurance is supposed to do by making sure that you do not risk more than you can afford to lose.

To submit a question to the FPA of
San Diego for possible publication, please send an e-mail to info@fpasandiego.org