

Is your home underinsured? 8 key points

MSN Money

After every natural disaster, too many people discover an awful truth: They don't have enough insurance to rebuild their homes.

Nationwide, more than two-thirds of homeowners are underinsured, according to a survey by insurance services firm MSB, by an average of 18%.

That means someone whose house cost \$200,000 to replace would find herself short by \$36,000.

Where homes and rebuilding costs are higher, the problem can be even more acute. A survey by United Policyholders, a consumer advocacy group, said 75% of California homeowners affected by the 2007 wildfires in San Bernardino and Riverside counties were underinsured by an average of \$240,000.

Trying to figure out the right amounts of insurance coverage, however, is a tricky, frustrating process.

Your insurance company or agent may be surprisingly little help and may even steer you wrong:

Many victims of Hurricane Katrina said their agents had told them they didn't need flood insurance when, clearly, they did. Courts ruled that insurers didn't have to pay for damage caused by flooding.

Likewise, many homeowners who lost property in the 2003 San Diego County wildfires complained that their agents had used a computer survey that vastly underestimated the cost of rebuilding their homes.

The survey, called Quick Quote, was part of a larger software package sold to insurers to estimate replacement costs and was later removed.

Homeowners often compound the problem by failing to report renovations to their insurers or by simply assuming their coverage is keeping up with inflation and replacement costs, which probably isn't true.

You might think insurers would err the other way, pushing folks to over-insure their homes. But that's generally not the case.

Lulled into complacency

Insurance analyst Brian Sullivan says the annual premiums paid on most policies are too small for insurers to spend much time doing a detailed assessment of customers' needs.

"If you ask most insurance companies what they're insuring — how many hardwood floors, how many fireplaces — they have no idea," said Sullivan, the editor of Risk Information, an industry newsletter. "It's only companies like Chubb that have policies with premiums in the thousands of dollars that will come

out and appraise your home and everything in it.”

Homeowners are often lulled into complacency because they have “guaranteed-replacement” or “extended-replacement” policies, which sound like they’ll cover the rebuilding of a home regardless of the cost, said attorney Amy Bach of United Policyholders, the consumer advocacy group.

But true guaranteed-replacement policies are almost extinct, and virtually all insurers cap their payouts at 100% to 150% of the amount for which the home is insured.

How to ensure adequate coverage

Bach recommends consumers buy the highest cap they can afford and take the following steps:

Use Web tools to estimate replacement costs. Bach recommends AccuCoverage, an MSB site that charges \$7.95 and walks you through a questionnaire that usually takes 20 to 30 minutes to complete.

Another site, HomeSmart Reports, charges \$6.95 and takes less time but offers less detail, Bach said.

HomeSmart Reports gives low and high estimates of what it would cost to replace your home, plus a standard cost of construction in your area, but it doesn’t account for custom features.

Compare the estimate with your policy limits. You’ll find them on the declarations page of your policy. If your insurer can’t explain discrepancies to your satisfaction, start shopping for another insurer.

Don’t be cheap. Make it clear to your insurer or agent that you want the best coverage for your money, not the lowest possible premiums.

Decide on disaster coverage. Floods and earthquakes aren’t covered by your homeowners insurance. If you’re in an area considered at high risk for hurricanes, you may have to buy insurance from a special windstorm-coverage pool. Unless you’re prepared to walk away from your home after a disaster, you need to consider such coverage.

Check your “loss of use.” Homeowner policies typically provide money to pay your rent and related living expenses while your home is being rebuilt. Again, you should find this coverage on the declarations page. If the amount offered wouldn’t cover you for two full years, Bach recommends asking for a higher limit or finding another insurer.

Get “replacement cost,” not “actual cash value.” It’s not just rebuilding coverage that falls short. Many policies severely restrict how much money you’d get to replace your stuff and limit or even exclude some common household items from your policy. If you have a policy that pays out actual cash value on your home’s contents, for example, you’d get a check for what your possessions were worth when they were destroyed, not what they would cost to replace.

It’s much better to spring for replacement cost on your contents. You’d typically still get an initial check for the depreciated value of your items, but after you replaced them and provided receipts to your insurer), you’d get another check to make you whole. The cost of this coverage is typically about 10% to

20% more than actual-cash-value coverage.

However, you still could be vulnerable. Some policies provide replacement-cost coverage for most items but make exceptions for others. Your policy might give you a check to buy a new couch, for example, but decide to depreciate your carpet and give you only a fraction of the replacement cost.

The only way to know how you're protected is to read your policy, front to back.

Many policies peg your contents coverage to a percentage of your overall policy limit. If your home is insured for \$200,000, for example, your contents coverage might be \$80,000 or \$100,000 or \$150,000, depending on the insurer's policies. Obviously, there's a lot of variation, and these limits don't reflect whether your furniture consists of Chippendale or chipped-and-dented. The only way to be sure you're adequately covered is to do a detailed household inventory, writing down all of your possessions and what they would cost to replace. A drag? Of course. But it's time you'll be glad you invested if you're ever faced with making a claim.

Make sure the good stuff has its own insurance. If you own something truly valuable, chances are good that your policy restricts how big a check you'd get. Most policies put payout limits of \$1,000 to \$2,500 on such items as jewelry, firearms, artwork and antiques. If you want full coverage, you need to purchase a "floater," or "rider," on the items at added cost. Consider your individual needs. Your policy likely has some other gaping holes.

Homeowners insurance typically won't replace equipment you use for a home-based business. Property belonging to a tenant is usually excluded. Damage from certain causes, such as a flood or sewer backup, won't be covered either. In these cases, you can get supplemental coverage — and you probably should. Protect yourself from lawsuits. That's the role of liability coverage. Chances are pretty good that you don't have enough protection, which means you could be in danger of losing everything you own to someone who decided to sue you.

Again, choosing how much liability to buy is tough. You can't predict who is going to sue you or for how much.

Although most insurance experts advise buying liability coverage equal to one or two times your net worth, a jury could come back with a whopping award that bears no relationship to what you own or could earn in a lifetime.

Still, trial attorneys tend to go for the easy money and often settle for the amount of your policy — unless you're vastly underinsured. Then they're likely to go to the time and trouble of identifying, and going after, all of your available assets.

That's why Steve Vidmar, an insurance defense attorney in New Mexico, recommends that most homeowners have at least \$1 million in coverage.

That means buying the maximum coverage your policy allows — typically \$250,000 to \$500,000 — plus an “umbrella” or personal-liability policy that provides coverage up to \$1 million.

“I’d recommend even higher limits,” Vidmar said, “for those with teenage drivers.”

Fortunately, boosting your liability coverage is still relatively cheap. A \$1 million umbrella policy usually costs \$200 to \$300 a year.

The time to make these adjustments is now. It’s too easy in the chaos of living to put off investing in your coverage, but it’s too late once a disaster strikes.