Two-Thirds of Homeowners Underinsured for Wildfire Loss

Investopedia

Regulators, insurers & advocates work to close gap in wildfire loss coverage

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As wildfires continue to grow in size and expense while ravaging or threatening residential areas, insurers and policy advocates are warning that roughly two-thirds of homes are underinsured. This means the cost to rebuild a total loss of a dwelling would far exceed the insurance settlement. Simply put, most homeowners insurance policies are not built to rebuild one's home from a total loss, something more and more people are discovering after wildfires spread to residential areas.

KEY TAKEAWAYS

- Wildfires often lead to total property destruction but most homeowners policies aren't sufficient to rebuild.
- On balance, about two-thirds of homes are underinsured, according to industry, advocates and officials.
- Homeowners can and should review their policies now and request adjustments for more coverage if needed, and know the cost to rebuild by square footage.
- Regulators are working hard with industry and consumer advocates to push for disclosures on coverage even as rebuilding costs soar due to economic factors.
- Check wildfire risk and fire hazards by zip code with online mapping tools.

Homeowners Face Potential Staggering Losses and Higher Premiums

Wildfires have burned 7 million acres on average annually since 2000, and 7.5 million in the most recent decade, according to the Congressional Research Service. This is more than double 3.3 million average annual acreage that burned in the 1990s, CRS found. In 2020, wildfires burned 17,000 structures, more than half of them residences, CRS reported.

Insurers and regulators are also reporting this sizable gap in coverage as wildfire season again looms, but all acknowledge there are many facets to this problem, understanding it and then dealing with it, often caused by tension in pricing.

“An estimated two-thirds of American homeowners policyholders are underinsured, typically by 20%, and by as much as 60%, imperiling their ability to recover in the event of a wildfire disaster,” warned Loretta Worters, spokeswoman for the Insurance Information Institute. “Moreover, as insurers reel from payouts spurred by recent wildfires—such as the $10 billion Campfire in 2018—residents are increasingly fearful for the fate of their own coverage and rates,” she said.

The high percentage of homeowners who do not or will not get enough of a payout from their insurer to rebuild their home is “frighteningly consistent,” across surveys and input from other data, according to Amy Bach, the veteran executive director of United Policyholders, a nonprofit insurance consumer advocacy organization for insureds.

The Complex Problem of Inadequate Coverage

Everyone wants to point the finger at the high rate of inadequately insured residential properties, but it is a three-part problem, Bach says.

First, the insurance agent software might skew low for replacement value and rebuilding costs, and most systems are calibrated on the likelihood that a person will never have a total loss, only partial.

For example, only 8% of homeowners who lost homes in the Marshall Fire in Colorado earlier this year had something called guaranteed replacement coverage, which covers rebuilding costs. Others might have extended or enhanced benefit coverage, which will pay out about 25% above your insured limit to cover a surge in construction costs, according to the Insurance Information Institute, or Triple I.

Second, the agent is caught in the middle and wants to make a sale, and doesn't want to make the cost appear to be too much and third, while people don't want to take the most expensive option and might think they are being oversold, according to Bach.

The fact that few have complete rebuilding coverage combined with inflationary costs, supply chain issue and labor costs means that most consumers are "woefully underinsured," according to Worters.

Regulators Grapple With the Underinsured Problem

Despite the fact people generally have homeowners' policies, "We are finding, especially in the current economic and financial environment, just because you are insured doesn't mean you're fully covered…," National Associations of Insurance Commissioners President Michael Consedine said during an April podcast with Colorado Insurance Commissioner Michael Conway on the recent wildfire experience in their mutual home state.

The Colorado Insurance Division has been and still is amassing data from wildfires so it can have a better picture of how to proceed in the future. Conway has said helping address the problem of the underinsured has angered him and made him passionate for developing a solution. According to the Division's analysis, Boulder County had 1,084 total losses from the Marshall Fire, the largest in Colorado's history.

The Division analyzed 951 total claim losses and estimated the underinsured costs at three price points for rebuilding: $250; $300 and $350 per square foot.1

The estimated total amount of underinsurance ranged from $39 million at $250 a square foot to $179 million at $350 a square foot, an amount Bach says is more realistic as a ballpark now for the cost of rebuilding a home.

At a rebuild cost of $250 per square foot, a total of 344 or 36% policies are underinsured in the fire that coursed through Boulder, Even at $300 per square foot, 55% of policies are underinsured, according to the Divisions' analysis, while, if the costs are $350 a square foot, 67% of the Marshall Fire properties are underinsured. This is the case even though 83% of the policies surveyed in the Marshall Fire had extended benefit coverage, which is not the more costly or rare guaranteed replacement coverage.

Because of this situation, disaster loans totaling $91.2 from the U.S. Small Business Administration have been approved for homeowners impacted by the fire, and will likely go towards the gap between insurance payouts and rebuilding costs, according to the regulatory agency.

Advocates, Industry and Regulators Offer Solutions

In the industry corner, insurance companies continue to work through their agents to educate consumers about having the right type and amount of insurance as does the insurance industry as a whole, the Triple I's Worters acknowledges.

Besides fortifying one's home to mitigate potential loss and damage, consumers are urged to to review their coverage now and ensure the information regarding their property is current and complete, including any recent upgrades, renovations or repairs that may impact the replacement cost, says Karen Collins, American Property Casualty Insurance Association assistant vice president.

Homeowners can also buy what's known as extended or enhanced replacement coverage, which will pay out about 25% above your insured limit to cover a surge in construction costs, but people generally don't want to buy more expensive coverage, Worters notes.

A homeowner can adjust the limits of a policy at any time, if the insurer is willing. "It is imperative that homeowners review, and if needed, update their insurance policy to keep pace with rising costs," Collins advises. APCIA research shows inflation, recent supply chain issues, and increased demand for skilled labor and construction materials following unprecedented natural disasters in the last two years have contributed to a significant increase in the costs to rebuild homes and businesses, in addition to delays resulting in longer timeframes needed to rebuild, she notes.

However, an insurer can reject coverage amounts, even with higher premiums, regulators have confirmed to *Investopedia*.

Price Points and Pressure Points

Consumer advocates and insurers suggest figure out square foot of living space in your home and then talk to builders per square foot and see how much it would cost to rebuild. While that is not always possible or easy to do, as most builders are busy, a good rule of thumb, is $120 per square foot for a tract home to $600 to a mountain house, according to Bach. However, she acknowledges that even $300 per square foot, a coverage amount that would leave more than half of the Marshall fire victims underinsured, is above what most people can afford.

You can adjust your limits any time if the insurers are willing. However, the more costly and more rare guaranteed replacement policy is not offered by all insurers and will cost more in premiums when it is.

Regulators in states heavily affected by wildfires like California, Colorado and Oregon have been meeting consumers, collecting data, working on enacting and then enforcing legislation that requires disclosures consumers about policy limitations or lack of coverage for wildfire perils and requiring minimum additional amounts to help consumers rebuild with upgraded mitigation measures such as fire sprinklers and solar panels, as in California.

We do tell the other Coloradans that there is “no one silver bullet,” says Vince Plymell, assistant commissioner to Conway. The commissioner has talked about good, more regular, more transparent information, Plymell said. He advises homeowners to dig into their policies and see whether they are covered sufficiently if the home were to burn down. Conway will be hosting a town hall meeting in mid-May to discuss the wildfire losses and coverage issues with consumers.

In California, Insurance Commissioner Ricardo Lara sponsored legislation signed into law by the governor in 2021 to address underinsurance with the possibility for larger payouts for those that rebuild on new land, which is now covered, and less red tape for living expenses from insurance companies.

Informational Webinars and Notetaking

Consumer advocate Bach advises that a homeowner be a “relentless notetaker” during the sales process and claim process to demonstrate later, if needed, what you were told about coverage, Bach suggests. Courts will say, unless you have evidence, the coverage shortfall situation is a “he said/she said,” Bach warns.

Every homeowners policy sold has an “invisible clause” saying that the insurance company has to act in good faith and act fairly with you, according to Bach. The problem is it is hard to prove the promises made to you unless you have evidence, such as notes of the conversation made at the time of sale. If you feel you are underinsured, contact your state insurance department to offer your data to add what you are receiving getting from the insurance industry.

After a wildfire loss when dealing with an insurer, Bach says it is helpful to hire a public adjuster to sort through the complex process, if one can.

Bach works with regulators to help homeowners who have had devastating losses from wildfires in recent years and hosted easy-to-follow webinars to help them understand the problem of underinsurance and figure out ways to prepare for and deal with the loss of a home from wildfire devastation.

Map Your Own Home's Wildfire Risk

Utilize natural hazards sites where you can enter your zip code and find your area's wildfire risk, although some of the information might be historical rather not be forward-looking. For example, the area that burned in Boulder was not considered high risk, according to Bach. For a current outlook, also try https://wildfirerisk.org and https://www.weather.gov/fire/.