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# Homeowner's Insurance

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## Why Homeowner's Insurance?

A home is the single biggest investment most individuals will ever make; it is typically the largest asset on the family “balance sheet.” Also, the contents of a typical home, in the form of furniture, appliances, clothing, family heirlooms, and other movable personal belongings, represent a substantial additional investment. The unprotected loss (or partial loss) of a home and its contents to theft, fire, windstorm, or some other disaster, could be financially devastating.<sup>1</sup>



Further, everyone faces the risk of personal liability. For example, a visitor to the residence could slip and fall. Such accidents can result in court decisions awarding large sums to the injured party for medical expenses, and “pain and suffering.”

## Coverage Under the Policy

Originally, a standard homeowner's policy covered only the risk of fire. Today's homeowner's policies provide protection against a number of the “perils” of modern life, in one “package” policy. A typical<sup>2</sup> homeowner's policy can provide insurance protection for the following:

- **Home:** The physical dwelling structure and other structures attached to it.
- **Other structures:** For example, a detached garage, pool house, guesthouse, green house, or tool shed.
- **Personal property:** This covers the contents of the home, such as furniture, appliances or clothing. Certain types of property<sup>3</sup> may have specific dollar limits.
- **Loss of use or additional living expense:** If a home is damaged by a covered peril, loss-of-use coverage helps meet the costs of hotel bills, apartment or rental home, eating out, and other living expenses while the home is being repaired. This policy section can also reimburse a homeowner for lost income if a room in the home were rented out. This is sometimes insured on an actual-loss-sustained basis.

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<sup>1</sup> Many mortgage lenders require homeowner's insurance, to protect the dwelling, as a condition of granting the mortgage.

<sup>2</sup> The specific coverage and terms of a policy can vary from company to company, and from state to state.

<sup>3</sup> Jewelry, silverware, securities, cash, and collectibles are examples of personal property subject to these “internal” policy limits.

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- **Personal liability:** Provides protection against legal liability for bodily injury or property damage if a third party is accidentally injured.
- **Medical payments:** Also known as guest-medical payments, this section provides coverage if a third party is accidentally injured and needs medical treatment.

### Policy Forms

There are several organizations that work with insurance companies to develop standardized homeowner's policies. While the details of a particular policy can vary, these standardized policies or "forms" are generally very similar.

- **Broad form policy (HO-02):** This policy covers the home, other structures, and personal property on a "named-peril" basis. Only the perils listed are covered.
- **Special form policy HO-03):** Coverage for the home and other structures is written on an "all-risk" basis; damage from any peril is covered, unless specifically excluded. Coverage for personal property is provided on a named-peril basis.
- **Comprehensive form (HO-05):** This policy covers the home, other structures, and personal property on an "all-risk" basis; damage from any peril is covered, unless specifically excluded. This form is typically used for more expensive homes.
- **Modified form coverage (HO-08):** This policy form is generally used with homes where the cost to re-build exceeds the market value of the property. Protection is provided on a named-perils basis. Payment is generally limited to actual cash value.

### Policy Exclusions

The standard homeowner's policies specifically exclude a number of perils from coverage. Policy coverage of these excluded perils can generally be added through an endorsement and payment of an additional premium. Typical policy exclusions might include the following:

- **Ordinance or law:** Many homeowner's policies do not cover losses, or have limitations, due to a law or ordinance of the community in which the home is located. For example, if a home is damaged or destroyed, changes in building codes could

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result in additional, uncovered expense when the home is repaired or rebuilt. Ordinance or law coverage is included in some package policies, often as a percentage of the dwelling coverage (10%, 25%, 50%, etc.). This coverage is required in some states.

- **Earth movement:** Excludes loss caused by events such as earthquake, volcanic eruption, or landslide.
- **Water damage:** Refers to damage from water that backs up from sewers or drains, or water seeping through walls. Many policies contain dollar limits for water damage due to such things as a broken pipe.
- **Flood damage:** Refers to damage from rising water, mudslide, or wave action.
- **Mold Exclusion:** Due to high claims activity for losses caused by mold, many insurance companies are excluding coverage for mold damage.
- **Other exclusions:** Other specific exclusions include war, nuclear hazard, neglect, and intentional loss.

### Other Issues

- **Replacement cost condition:** Dwelling and other structures: If a home is damaged or totally destroyed, a homeowner's policy will generally pay (within policy limits) to rebuild or repair on an "actual-cash-value" basis. In simple terms, actual cash value means replacement cost, less a deduction for depreciation or for wear and tear. Reimbursement on this basis could leave a homeowner short of the total funds needed to restore the home.

Through an endorsement and payment of an additional premium, reimbursement can be on a "replacement-cost" basis. Replacement cost means, simply, restoring the home to its previous condition, using materials and workmanship of similar quality. In some policies, the availability of this feature requires the homeowner to maintain coverage on the home equal to at least 80% of the cost to rebuild or repair. If insurance coverage were not maintained at the 80% level, any loss would be reimbursed at a lesser amount, or on an actual-cash-value or depreciated basis.

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- **Replacement cost:** Personal property (contents): Coverage is normally on an actual-cash-value basis. For an additional premium, the policy can usually be endorsed to protect covered personal property on a replacement-cost basis (the cost to buy the item new today) without considering depreciation.
- **Inflation guard rider:** The standard policy forms can usually be endorsed to provide for automatic, periodic increases in policy limits. These increases in policy coverage generally apply to both the dwelling and contents, and help avoid being underinsured due to inflation. Such an endorsement also helps meet the 80%-of-replacement-cost condition to qualify for replacement cost on the home.

### Understand the Policy

An insurance policy is a written contract between the insured and the insurance company. The protection provided by the policy typically represents a significant part of an individual's overall risk management program. Thus, it's important for an insured individual to read and understand key policy provisions such as the following.

- **What perils are covered in the policy?** A basic policy may not provide as much protection as is necessary.
- **What perils are not covered?** For an additional premium, perils or situations not covered can often be added to a policy.
- **What are the limits of coverage?** This refers to the maximum dollar amount the insurance company will pay, in the event of a covered loss.
- **What are the deductible amounts?** A deductible is a dollar amount or percentage the insured must pay before the insurance company pays its portion of the loss.
- **In the event of a loss, what are the duties of the insured?** A policy will usually list the steps that must be taken in the event of a loss.

### Seek Professional Guidance

Insurance agents and brokers, insurance counselors, and other trained financial consultants can help provide answers to detailed questions about a particular policy. These professionals are also helpful in selecting the right policy and the appropriate amount of coverage.