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How Much Homeowners Insurance Do You Need? Probably More Than You Have

A home purchase comes with excitement and quite a bit of stress until the long-awaited moment arrives: the closing. With the keys to your new home in hand, you pass the threshold into your future filled with visions of friends, family, celebrations, and many other memorable moments. You've surmounted all the hurdles.

Whether this story is one you experienced years ago or just last week, after dozens of signatures and negotiations, your homeowners insurance policy is probably not top of mind.

If you've been in your home for a few years without a coverage review, the chances are good that you're underinsured. Also, even if you bought recently, you may have grabbed a homeowners policy without much thought just for the sake of closing. Now that you're in your home and things are settling down, it's a good time to make sure you have the coverage you need for the long haul.

Deciphering your policy

It's hard to review a policy that tops 20-plus pages. Much of it reads like legalese, but it's still important to understand. Here are a few areas to focus on when considering your homeowners coverage and limits.

Start with your declarations page

Your declarations page summarizes your homeowners coverage, and it appears on the first few pages before the contract language. The declarations (or "dec") page lists your coverage types and limits (the maximum amount the insurance company will pay to you in a covered loss), such as these basics:

- **Dwelling (coverage A)** protects the structure, like your roof, flooring or other materials
- **Other structures (coverage B)** protects things not attached to your home, like a fence or shed
- **Personal property (coverage C)** protects your personal property and moveable things in your home such as appliances, clothing, jewelry or electronics due to a covered peril
- **Loss of use (coverage D)** reimburses your expenses if you need to live elsewhere after a covered peril
- **Personal liability (coverage E)** helps with property damage and bodily injury claims made by other people that you're legally obliged to pay
- **Medical payments (coverage F)** helps with medical expenses to other people for bodily injury that happened while on your property

You might have more (or less) coverage than appears on your declarations page, so make sure to verify the policy with your insurance professional.

Lenders interests and your interests: a tale of two liabilities

In your mind, the purpose of insurance is to protect you and your belongings and to help you out in a disaster. The mortgage lender's interest is to protect their original investment, which is the outstanding loan on your home. Unless you have no mortgage, your home is insured as required by your lender. But there's a good chance that the level of protection you chose in order to buy your house doesn't adequately protect your liability risk exposure today.

Your home insurance should cater to the sweet spot that meets both interests:

- Coverage to get your house structure rebuilt (so you resume payments to the lender or, if you don't resume payments, the lender receives compensation for the loan and retains ownership)
- Coverage to replace your belongings, rehouse you while they rebuild, and finally get your home back to the way it was before the event

Keep in mind that homeowners insurance offers protection that goes beyond your home and covers your personal liability exposure, too. That alone might be worth a call to your insurance professional.

Replacement value or market value?

You might think it's enough to insure your home for market value (the cost people are willing to pay for your home), but the replacement value (the cost to rebuild from the ground up) of your home may far exceed its market value. Your home's market value today could be quite different next year. The cost of materials used to rebuild your house is likely a steady increase year-over-year.

Some homeowners policies include inflation guard (usually 2% to 4%) but not all. Check with your insurance professional to verify that you have inflation protection.

The purpose of insurance is to make you whole again or put you back in the same type of house you had before the loss. To protect your budget from risk liability exposure, you should itemize, evaluate and determine the value of your home upgrades, materials, personal property and contents.

You can start to get an idea of your liability by creating a home inventory. Make a note of the contents as well as the materials used to build your house. Think upgrades, collectibles, construction materials, electronics, clothing, furniture, appliances – everything.

Policy limits and catastrophic coverage: an example

Let's say you have a $200,000 limit on your dwelling and a $100,000 limit for personal property. Your house catches fire and the blaze spreads to your custom detached garage. Everything is destroyed: The insurance company writes it off as a total loss.

Will $200,000 be enough to rebuild (using today's prices for materials)?

- ***Consider everything it will cost to rebuild your home (the roof, siding, lumber, nails, gutters, flashing, insulation, windows, deck, etc.). Then consider the internal workings of your house like the walls, crown molding, flooring, carpet, floorboards, paint, built-ins, HVAC, boiler, generator, water heater, whole-house dehumidifier or water filtration system.***

Now ask yourself again: Will $200,000 cover the cost to restore what you had (using today's pricing for materials)?

- ***When you reach your insurance policy limits, the money stops. You may have to forgo the custom reclaimed wood flooring or solar panels you had before the fire, just for the sake of getting a roof over your head. Either that or you're paying out of pocket. And who wants to pay twice?***

- ***Other structures include limits that equal 10% of your home's coverage limit. Will $25,000 cover the cost of your fully insulated two-car garage with a woodshop? You might be disappointed if you end up with a drafty single-car garage instead.***

Top off your total loss with a list of items needed to replace everything in your home.

Will a $100,000 limit on personal property be enough to replace everything you own?

- ***Consider rugs, drapes, furniture, clothing, electronics, jewelry, collectibles, artwork and appliances. (A high-end kitchen could quickly deplete 30% of a $100,000 limit, all by itself.)***
- ***Replacement value (RV) reimburses the cost to replace without depreciation.***
- ***Actual cash value (ACV) reimburses for the cost to replace minus depreciation.***

Ask your insurance professional to help you decide on the reimbursement value and limits that are right for you.

Other ways to cover your homeowners risk liability gaps

Now that you've done your homeowners inventory, ask your insurance professional about ways you can close the liability gap and insure against loss. Here are some options to consider:

- **Additional living expenses (ALE)** coverage helps out if you're forced to live somewhere else while your home is rebuilt or rehabbed. Consider the cost to continue living in your area, especially if you have school-aged children.
- **Building ordinance or law** protects you if a (covered) peril damages parts of your home and the city forces you to upgrade the entire house to code.
- **Riders or floaters** cover specialty items like jewelry, computers and silverware (generally up to $2,500).
- **Collectibles insurance** (scheduled property endorsement) covers high-ticket items like artwork, designer handbag stashes, antiques or other collectibles.

- **Other structures** covers anything not attached to your house. Think about increasing this coverage if you've got some stylish outbuildings or elaborate fencing.
- **Personal liability** usually covers up to $100,000, but you might want to go higher to protect yourself from footing the bill for a lengthy lawsuit.
- **Extended replacement cost** is another way to handle inflation. You can increase your home's replacement value up to 50% over the guaranteed replacement cost to rebuild; this is especially useful if you're faced with price gouging after a natural disaster.
- **Sewer backup** covers you in case of a sewer line or sump pump backup.
- **Flood** is a separate line of insurance that you can buy. Most floods occur outside identified flood plains and can happen anywhere (snow melts or flash rains, for example). Anyone is vulnerable to this costly liability.
- **Earthquake** is available as a separate line of insurance. Earthquakes can occur anywhere, not just in California. If an earth tremor structurally damages your house, your budget might get rocked, too.
- **Comprehensive** (H05 form) offers broader coverage than a standard homeowners (H03 form) policy, such as coverage for lost or misplaced jewelry instead of theft only.
- **Personal umbrella** coverage kicks in when you hit the limit on your policy. If you have home and auto policies, an umbrella will open over either policy when it's reached its limit.

Schedule a review with your insurance professional

Now that you've nailed down the jargon, you're in the know. Reach out to your insurance professional and set some new coverage limits. Build your risk liability plan and seal the gaps with a strong homeowners insurance foundation that protects you and your investment with an eye on the future.

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