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The Basics

Why 2 out of 3 homes are underinsured

Stingier policies and rising construction costs mean many American homeowners would face huge out-of-pocket expenses if disaster struck. Are you covered?

By Liz Pulliam Weston

If your home burned down tomorrow, chances are good you wouldn't get enough money from your insurance company to replace it.

A whopping two out of every three homes nationwide are under-insured, according to a survey by Marshall & Swift / Boeckh. This Princeton, N.J., company specializes in estimating construction costs, and its annual reviews of 3 million insurance policies consistently show homeowners don't have enough coverage.

We're not talking small amounts, either. The latest survey showed the typical homeowner was underinsured by 27%. That's an improvement from a couple of years ago, when 73% of homes were underinsured by an average of 35%, but still shows most homeowners are at risk.

Remodeling, stingier policies take toll

These figures aren't news to the insurance industry, which has known for years that most of their customers weren't buying enough coverage.

Several factors are at work:

- **Insurance policies cover less than in the past.** In the past five years, the vast majority of insurers have done away with, or radically modified, their guaranteed replacement policies. Whereas once your company would rebuild your home no matter the cost, today most insurers cap how much they pay to 120% of your policy's stated coverage amount.

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- **Construction costs are on the rise.** The cost of rebuilding a home has risen about 3% a year on average for the past decade, said Gopal Ahluwalia, economist for the National Association of Home Builders. Many homeowners haven't updated their coverage to reflect those costs. "Often, the last time people think about their homeowners' insurance is when they get a mortgage," said Loretta Worters, spokeswoman for the Insurance Information Institute, a trade group.
- **Homeowners are remodeling like crazy.** Americans spent \$180 billion in 2003 updating their homes, often boosting the value of their homes in the process. An estimated 75% of remodelers fail to update their insurance coverage to reflect those improvements, said Bob Crine, president of Marshall & Swift, the construction estimating company.

"Most people don't think when they remodel their home to tell their insurer," Crine said. "When you think of all the money that's going into houses that doesn't get picked up (by policy coverage increases), you begin to see the problem."

Crine's 70-year-old company uses a huge insurer-supplied database that compares existing coverage with construction costs in different areas all over the country. In addition, some homeowners are asked to complete surveys detailing all the features of their home, while others houses are inspected personally by Marshall & Swift employees.

The company has found that homeowners consistently shortchange themselves when it comes to getting enough coverage, Crine said. Homeowners have more at stake now, however, because so many insurers have capped their replacement coverage.

The insurance industry isn't rushing to fix the problem, either. Consumers are already sensitive about rising homeowners' premiums, and few agents want to risk losing a customer by suggesting they pay even more.

"Really, people have to take the responsibility on themselves" of monitoring their coverage and making sure they have enough, Worters said. "I wouldn't want to rely on one person (your agent) who may or may not know what your needs are."

The best insurers, Crine said, ask their customers numerous, detailed questions about the features of their homes to determine how much coverage they should have. Others rely on less effective methods, such as multiplying the home's square footage by average construction costs in the area.

The problem with using average construction costs, said Ahluwalia of the builders' association, is that your home could cost much more to rebuild.

"A basic home with regular carpet, two bathrooms and no fireplace is going to cost a lot less (to rebuild) than a home with two fireplaces, a three-car garage and hardwood floors," Ahluwalia said. "And the trend has been to update and improve everything, not only in new houses but in existing stock."

Are you covered?

So how can you tell if you have enough coverage? Take the following steps:

- **Read your policy.** It's not exactly summer beach reading, but insurers have generally made their policies more understandable in recent years. You should be able to get a good idea of what's covered and what's not. If you have any questions, call your insurer and ask.
- **Insure the house, not the land -- or the mortgage.** The price you paid for your home, the amount it's worth now and the mortgage you're carrying are all pretty much irrelevant when it comes to determining how much insurance you should have. What you really need to know is how much it will cost to rebuild your house, and that could be significantly more or less than any of the above figures. Nationally, about 24% of the average home price is the value of the land, Ahluwalia said, although that percentage can spike to over 50% in expensive markets such as Orange County, Calif., New York or San Francisco.
- **Use averages only as a starting point.** The average cost for building a home nationally ranges from \$65 to \$150 a square foot, Ahluwalia said, with homes on the coasts and in major metropolitan areas coming in on the high end of that range. Custom-built homes in these high-cost areas often can cost \$200 to \$400 a square foot. "The average homeowner in today's market should start with (rebuilding costs) of \$75 to \$85 a square foot, and then make adjustments from there," Ahluwalia said.
- **Talk to builders in your area.** If your insurer can't help you nail down the cost of rebuilding your home -- and many can't -- your best bet may be to chat with contractors doing work in your neighborhood. Their ballpark estimates are likely to be much more helpful and accurate than a guesstimate from a company or agent who isn't as familiar with the quality and cost of homes in your area. If you're still having trouble coming up with a solid estimate,

consider hiring an appraiser to do the job. This can cost you \$200 to \$300, but in the long run could save you a world of grief.

- **Consider adding upgrade coverage.** The older your home, the more it will cost to bring it up to current codes -- and those costs typically aren't covered in the standard replacement policy being sold to most homeowners. Upgrade coverage is a relatively inexpensive addition to your policy that could pay off should you ever face disaster. And the possibility of disaster is, after all, why you have insurance in the first place. Make sure you have enough so that the tragedy of a fire or other disaster isn't compounded by not having enough money to rebuild.

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