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Homeowners Come Up Short on Insurance

Industry Redefines Idea of 'Replacement'

By JOSEPH B. TREASTER

Karla and Bruce Carroll remember the sheriff on his bullhorn ordering residents to evacuate and, minutes later, hearing the roar of monstrous flames arcing toward their modest home here in the hills above San Diego.

Mrs. Carroll grabbed a family photo album as they ran to safety; Mr. Carroll started to gather his fishing rods. But she hustled him along. "Don't worry about those things," she recalls saying at the time. "We've got insurance."

But, the Carrolls say, the insurance they bought from State Farm, the nation's largest property insurer, has left them at least \$100,000 short of the cost of rebuilding their home. Today, nearly a year later, they are still wrangling with their insurer and living in a 29-foot-long house trailer on the land where their three-bedroom home once stood, overlooking a spectacular sweep of ridges and canyons.

Their woeful shortfall in insurance coverage, experts say, is a plight shared unknowingly by millions of American homeowners. It has been fed largely by a shift in the way property insurance has been sold in recent years.

In a move to cut costs from claims, insurance companies began in the late 1990's to phase out coverage that guaranteed the replacement of a destroyed home, regardless of the expense to the insurer. In place of that unlimited coverage, which had become nearly universal, insurers substituted a similar-sounding policy with a crucial difference: it pays only the amount stated on the policy plus, typically, an additional 20 percent to 25 percent.

For their part, insurers insist that it is



Alan Decker for The New York Times

Bruce and Karla Carroll have been living in a trailer at the site near San Diego where their home burned in the fall of 2003. Their insurance has left them at least \$100,000 short to rebuild.

the consumer's responsibility to acquire adequate coverage.

The old policy was called a guaranteed replacement policy. The new one, which

By one estimate, 64 percent of homes are underinsured by an average of 27 percent.

most Americans now have, is called an extended replacement policy.

"People look at this and it says 'replacement' and they think, 'That's good, I get my house replaced,'" said John Garamendi, the insurance commissioner in California. "But they don't get their house

replaced. They get money up to the set limits plus the extended 20 percent or 25 percent."

Marshall & Swift/Boeckh, a Los Angeles company that most insurers rely on for help in calculating the value of houses, estimates that 64 percent of American homes are underinsured by an average of 27 percent, with some homes underinsured by 60 percent or more.

Another insurance industry company, AIR Worldwide in Boston, estimates that many upper-income homes in New England are underinsured by 30 percent to 40 percent.

"The underinsurance problem lies just beneath the surface all across the country," said Robert P. Hartwig, the chief economist for the Insurance Information Institute, a trade group in New York.

The insurance gap has been worsened by the nationwide housing boom that has been rapidly driving up the cost of lumber, bricks, cement and other construction materials, industry executives say. And in

Southern California, rebuilding costs soared even higher as the demand for contractors and building supplies suddenly jumped after the Carrolls' home and several thousand others were destroyed in wildfires over a few days last October.

But such explanations do not satisfy the industry's critics, who say insurers have shifted the burden of such mistakes onto homeowners.

"Most people go to their insurance agent to buy coverage and figure they're fully covered," said J. Robert Hunter, the director for insurance at the Consumer Federation of America. "But often they're not."

The issue of underinsurance has not attracted much attention because, of the millions of insurance claims every year, fewer than 2 percent are for the total loss of a house. But the wildfires here last fall came as a jolt. They quickly incinerated more than 3,700 homes and, Mr. Garamendi said, "a very large proportion" of them were underinsured.

Consumer advocates and industry executives expect similar problems for the victims of Hurricane Charley in Florida as they begin working through their claims.

"The problem is everywhere," Mr. Hartwig said. "The disasters simply expose it."

George Kehrer, a lawyer and building contractor who founded Community Assisting Recovery in Los Angeles more than a decade ago to help people with insurance claims after disasters, said he had spoken to 1,200 people who lost homes in the California fires.

"About a dozen of them," he said, "were adequately insured."

No single factor is entirely to blame for the underinsurance, consumer advocates and industry executives say. Homeowners, they say, need to recognize their own responsibility.

But under pressure to make sales, Mr. Garamendi and consumer advocates explain, insurance companies and their agents often aim low in valuing houses. The goal, they say, is to keep premiums down to keep customers from going to competitors, and sometimes even a few dollars can make a difference.

"If they quote a realistic replacement cost, the price of the policy goes up," Mr. Garamendi said, "so they are motivated to keep the replacement cost down."

Insurance industry executives argue that it would make no sense to undervalue homes intentionally. The higher the in-

surance coverage, the higher the premium, they point out.

But Mr. Garamendi disagrees. "You want the sale first," he said. "O.K., you can get a little more premium if you give full coverage. But you lose the sale."

Mr. Hunter, the consumer advocate, said agents often lacked the training to assess accurately the value of a home, usually done these days with the help of a computer program. Rarely do the agents leave their offices to assess a house personally, agents and industry executives said.

Mr. Garamendi said some agents inadvertently undervalued homes by using a computer shortcut to obtain what is known as a "quick quote." Then, when a customer decides to buy coverage, the agent fails to add details like designer cabinets and fixtures that tend to increase the replacement estimate and the cost of the insurance.

While most insurance policies include a built-in escalator to keep pace with general inflation, the costs of building supplies and paying for construction crews have been rising at a faster pace, in many cases widening the gap between the amount a house is insured for and what it will cost to rebuild it.

Another factor in the insurance gap has been a failure by some homeowners to increase coverage after the spurt in home improvements, from new kitchens to extra bedrooms, as millions of Americans have used cheap money from mortgage refinancings in recent years to upgrade their homes.

Still, in dozens of interviews over several days this month, owners of the homes in Southern California that were destroyed said repeatedly that they had been led to believe they had bought enough coverage to rebuild their homes and were stunned to find out they were wrong.

Mrs. Carroll said she first bought her insurance from State Farm in 1998 shortly after she and her husband acquired their home for \$172,500.

"I told them I wanted full coverage for my house," she said. "I've lived in this area most of my life, and I knew there was a huge fire risk here. I had been evacuated for fires three times as a child."

Two years later, she said, she checked back with the agent to make sure she had enough coverage and increased the coverage for possible additional costs as a result of changes in building codes.

"I said, 'Are you sure this is enough to replace the house?' and she said, 'Oh, that's plenty of coverage,'" Mrs. Carroll recalled. "She had me convinced my house could burn or fall down in the canyon under heavy rains and, yeah, it's covered."

At the time of the fire, the Carrolls' house was insured by State Farm for \$126,000, which, following standard practice, did not reflect the value of the land. Their annual premium was \$730.

With 20 percent in extended replacement coverage and other standard features including a built-in adjustment for inflation and coverage on their two-car garage, fences and driveway as well as an additional 25 percent for anticipated building code changes — upgraded by Mrs. Carroll from the usual 10 percent — the Carrolls estimate their policy will pay them about \$222,000. But Mrs. Carroll said a contractor hired by State Farm estimated that replacing their losses, not including their clothing and other personal things, would cost nearly \$400,000.

Bill Sirola, a spokesman for State Farm, said it was not clear whether the Carrolls were underinsured. "We are working with that family," Mr. Sirola said. "We are working with other builders on their behalf to get other estimates of their rebuilding costs."

As the insurance companies see it, if people are underinsured it is primarily their own fault.

"It's the homeowner's responsibility to see that his home is properly insured," said Mr. Hartwig of the Insurance Information Institute.

Insurers say the terms of coverage are clearly spelled out in their policies. In California, insurers are also required to mail a statement annually specifying the terms of coverage along with renewal notices.

But many homeowners burned out by last year's fires say they made clear they wanted to be able to replace their homes. In interviews, they said they had no way of knowing how much insurance they needed and relied on the agent to set the proper value and charge the appropriate price. Many say they would have been willing to pay more to assure themselves that their losses would be fully covered.

"They're the experts," said Donald McCormick, a high school math teacher, who lost his home in the Scripps Ranch section of San Diego. "I don't go to the doctor and tell him how to do surgery."

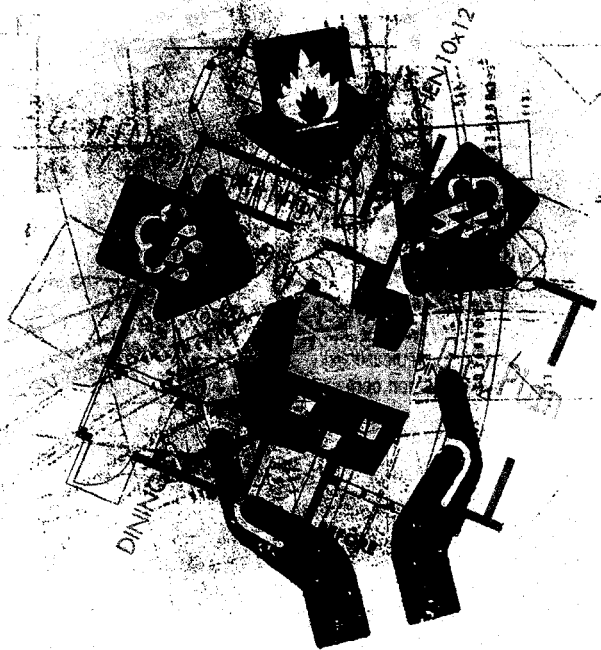
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The Home Insurance Mistake You May Be Making



Think that if you lost your home in a disaster, insurance would pay to rebuild it? Think again. Most homes are significantly underinsured. Here's how to make sure you don't get a shock

Last June, after an electrical fire gutted their century-old Brooklyn home, Steven Lawitts and Nancy Ranger counted their blessings. No one was hurt, and they expected their homeowner's insurance would cover them. Even though they had been careful to maintain their replacement insurance policy with inflation protection, they *didn't* bargain on the estimated \$50,000 needed to upgrade their original plumbing system, which couldn't be replaced as it was but had to be brought up to code. "Turned out our policy didn't cover that," says Lawitts.

A whopping 61 percent of American homes are underinsured by an

average of 25 percent, according to a recent report by Marshall & Swift/Boeckh, a company that tracks building costs in North America. Anyone with a mortgage must carry some form of home insurance, and more than 95 percent of homeowners do. But, like Lawitts and Ranger, these families may eventually find that even though they're insured, they will be responsible for substantial out-of-pocket costs if they're forced to rebuild and don't want to settle for a lesser home than the one they were in.

One cause of underinsurance is confusion about what's covered by very different policies with very similar names. Here's an overview of the most common options, so you can determine what's best for you.

- **Guaranteed Replacement Coverage.** These policies cover whatever it takes to restore part or all of your house as closely as possible to the way it was, without financial limit. They guarantee that if your house is destroyed, it will be rebuilt to the same structural specifications and out of comparable materials (although they do not necessarily insure that one-of-a-kind materials will be replicated). Although these are not the least expensive of policies, the premiums are usually not unreasonably high. Unfortunately, these policies are increasingly rare, in part because insurance companies are reluctant to issue and fulfill them, owing to soaring costs.

- **Replacement Coverage.** While it doesn't guarantee that your house will be replaced as is and in full, this kind of coverage does insure your property up to a specific

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BY LESLIE JAY

dollar amount, without any depreciation. The financial risk here stems from the rising cost of construction. A replacement amount that seems sufficient when you first buy the house may not cover the costs of reconstructing it 10 years later.

Insurers also offer extended replacement policies, which add a cushion of an additional 20 percent to 25 percent of coverage to the value you

home's contents. For jewelry, fine paintings, antique furniture, silverware and other valuables, you'll probably need extra endorsements known as "floaters" or "riders."

• **Actual Cash Value Coverage.** These policies are the least expensive but also the least desirable. The insurance company assesses the value of your house according to its age and condition, not market value. So al-

coverage amount. Homeowners often assume that since they were able to get a mortgage on their homes, their current protection is adequate, but that's not true. Some homeowners are covered only for the amount their home cost them to buy, not the total price of reconstruction. To get a more accurate idea of what it would cost to rebuild your home with the same materials inside and out, your best bet is not necessarily an insurance assessor or a real estate agent but local home contractors and builders, who will be able to assess more accurately the cost of rebuilding (which is often not the same as market value). To get a ballpark figure, call several nearby companies in the industry and ask for the price of construction per square foot.

After you've decided on your best policy choices, shop around. Even within a city, policies, coverage and prices vary widely. Independent insurance brokers, who work with multiple agencies, may be able to handle much of your preliminary legwork, and their commissions are usually paid for by the insurance companies.

Finally, once you've gotten the coverage you want, review it regularly. The details of policies can change from year to year, so be sure to read the updates from your insurance company. "When you get your renewal notice, do a side-by-side comparison," recommends Jim Hurley, director of public information for the Texas Department of Insurance. And be sure to factor in any home improvements you have made. If that new deck or renovated bathroom hasn't been reported, it won't be rebuilt. ♣

A majority of American homes are underinsured by 25 percent

and the insurance company agree to insure your house for. Depending on the amount stipulated, replacement and extended replacement policies "can both be good deals," says Jeanne Salvatore, vice president of consumer affairs at the Insurance Information Institute, in New York City.

• **Modified Replacement Coverage.** This alternative lets insurers minimize the costs of repairing any damage done to older homes by using modern materials if they are less expensive than the original materials they are replacing. For example, when you have one of these policies, your original plaster walls might be replaced with Sheetrock.

• **Luxury Home Policies.** If you want to be sure that those stained-glass windows and customized moldings will be replaced with items of equal quality, this may be the right option for you—if you can afford it. Names for these policies vary, but Chubb and other firms specialize in such products for expensive homes. Bear in mind that, like most other forms of home insurance, these policies won't necessarily cover all of a

though you'll have lower premiums, your policy won't give you enough to replace your home as it was.

In addition, there are supplements to those policies that you can use to customize your coverage:

• **Building Code Upgrade Insurance.** When older buildings require major repairs or reconstruction, whatever's out of date will need to be brought up to the latest code standards. As a supplement to your basic policy, this upgrade will help with those costs.

• **Inflation Guard Endorsements.** The value of your property, as well as the costs of construction supplies and labor, will most likely continue spiraling upward. This policy provides a buffer for those costs. "The insurer automatically raises the amount of insurance according to a formula that takes into account a variety of indexes that track inflation," explains Tim Wagner, director of insurance for the state of Nebraska.

The key to getting the coverage level you need is to select the right

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