Homeowners

20M

Similar to auto insurance, the coverages of ***homeowners insurance*** are divided into multiple sections. There are two main sections: Section I - Property Coverages and Section II - Liability Coverages. In addition, there are four coverages included in Section I and two coverages in Section II. The table below summarizes the coverages under each section of homeowners insurance.

Section	Coverage	Description
I (Property)	A	Dwelling
	B	Other Structures
	C	Personal Property
	D	Loss of Use
II (Liability)	E	Personal Liability
	F	Medical Payment to Others

There are many factors that affect the premium rates for homeowners insurance. Here are a few examples:

- Geographic location - Distance to nearest fire station, probability of natural disasters
- Construction - Type of materials, presence of security or sprinkler system
- Value of dwelling

Coverage A - Dwelling

Coverage A insures against damages to your house from specific perils or on an all-risks basis up to a specified limit. Some perils are specifically excluded from the basic coverage to make rates more affordable. Examples of exclusions are:

- natural disasters, such as earthquakes and floods
- criminal or intentional acts by the insured
- nuclear accidents
- acts of war or terrorism

To determine whether an insured will be covered for any losses or damages, the ***doctrine of proximate cause*** will be considered. This principle states that a loss is covered if and only if a ***covered peril*** is the proximate cause of a ***covered consequence***. Note that both the peril and consequence have to be covered under the policy and the peril must be the proximate cause.

Coverage B - Other Structures

Coverage B protects against damages or losses to the garage or other structures of the dwelling. If the structures are used for business purposes or rentals, damages or losses will not be covered.

Coverage C - Personal Property

Coverage C provides insurance for the policyholder's personal property and the contents of the house. Most insurers cover the actual cash value, but for an additional premium, some insurers offer replacement cost coverage. Coverage C also extends to borrowed property under the possession of the insured, as well as personal property that is outside of the house.

INSIDE LIMITS

Under personal property coverage, ***inside limits*** apply to specific losses. For example, there may be a limit to the amount of compensation for stolen cash.

In addition, there are inside limits on coverage for jewelry, silverware, and art. If the homeowners want to insure these items fully, a schedule of these items and their appraised values will be attached to the policy. If these items are damaged or stolen, the insurer will pay the appraised values, not the market values. This benefit is called ***valued benefit***.

Coverage D - Loss of Use

Coverage D provides compensation for additional living expenses and loss of rental income. This coverage will pay a fair value for alternative accommodations while repairs are being done on the house. It will also indemnify the loss of rental income if parts of the primary dwelling were rented out before the loss.

Coverage E - Personal Liability

Coverage E provides third-party liability coverage if a third party is injured or if a third party's property is damaged on the insured's premises. Similar to auto insurance, the injured party needs to prove that the insured is liable for the injury or loss.

Coverage F - Medical Payment to Others

Coverage F, on the other hand, provides medical benefits to any third party injured on the insured's premises, without the insured being sued. This means that a third party can receive medical benefits even if the insured is not at fault.

Tenants Package

Those who rent instead of own a house can purchase a ***tenants package*** policy, also known as renters insurance. This policy is similar to homeowners insurance, except that it provides less coverage because there are fewer risk exposures. Due to the nature of renters insurance, it mostly covers personal possessions.

Coinsurance

The ***coinsurance provision*** penalizes the insured if the limit purchased is less than a specified percentage of the full value of the dwelling.

The coinsurance provision exists because the distribution of homeowners insurance losses is heavily weighted toward smaller amounts. If insureds are allowed to purchase lower limits of insurance and receive full coverage (subject to the limits) without penalty, they will pose greater risk to the insurance pool.

With coinsurance, the insurance benefit is calculated as:

$$P = \begin{cases} \min\left(I,\ \dfrac{I}{cF} \times L\right), & I < cF \\ \min(I,\ L), & I \geq cF \end{cases} \tag{S1.1.2.1}$$

where

- P: Compensation amount
- I: Limit, or insured amount
- F: Full value of the house at the time of loss
- c: Coinsurance percentage
- L: Loss amount

Example S1.1.2.1

Jon has a homeowners insurance policy through Safe House Insurance. His house is insured for 150,000.

Safe House's homeowners insurance policy has an 80% coinsurance clause, which requires all policyholders to insure at least 80% of the full value of their house.

During the policy year, Jon incurs a loss estimated at 50,000. At the time of the loss, his house is valued at 250,000.

Calculate the amount Safe House will pay to compensate for this loss.

Solution

Based on the question, we can deduce that:

$$\begin{gathered} I = 150{,}000 \\ c = 0.80 \\ L = 50{,}000 \\ F = 250{,}000 \end{gathered}$$

Notice that:

$$cF = 0.80\,(250{,}000) = 200{,}000 > I = 150{,}000$$

Therefore, the compensation amount is:

$$\begin{aligned} P &= \min\left(150{,}000,\ \frac{150{,}000}{0.8(250{,}000)} \times 50{,}000\right) \\ &= \min(150{,}000, 37{,}500) \\ &= \mathbf{37{,}500} \end{aligned}$$

Example S1.1.2.2

Garrett has a homeowners insurance policy through Protect House Insurance. His house is insured for 175,000.

Protect House's homeowners insurance policy has a coinsurance clause of $\alpha\%$.

Due to a tropical storm, Garrett experienced a loss of 100,000. Protect House paid him 80,000. At the time of the loss, his house was valued at 300,000.

Calculate α.

Solution

Based on the question, we can deduce that:

$$I = 175{,}000$$
$$c = \frac{\alpha}{100}$$
$$L = 100{,}000$$
$$P = 80{,}000$$
$$F = 300{,}000$$

Notice that the compensation amount, P, is not equal to the insured amount, I, or the loss amount, L. This means that $I < cF$.

Using Equation 4.1.1, we have the following equation:

$$80{,}000 = \frac{175{,}000}{\frac{\alpha}{100}(300{,}000)} \times 100{,}000$$

Solve for α.

$$80{,}000 = \frac{5{,}833{,}333}{\alpha}$$
$$\alpha = \mathbf{72.92}$$

Example S1.1.2.3

Quinn buys a commercial insurance policy from Protect House Insurance.

The insurance policy has a limit of 90,000, a coinsurance clause of 70%, and a 1,000 deductible. A deductible is the amount the insured has to pay before the insurance coverage kicks in.

A hurricane causes damages of 10,000. Quinn receives a payment of 8,000 from Protect House.

Calculate the actual value of the property at the time of the loss.

Solution

Notice that we have an additional insurance component to deal with: the deductible. The deductible is applied before the limit or coinsurance are applied. This means the policy would pay $L - d = 10{,}000 - 1{,}000 = 9{,}000$ if Quinn was adequately insured. However, since the payment is less than 9,000, we know that Quinn is penalized for underinsuring, i.e. $I < cF$.

Based on the question, we can deduce the following:

$$I = 90{,}000$$
$$c = 0.70$$
$$P = 8{,}000$$

Solve the following equation for the property value:

$$\frac{I}{cF} \times 9{,}000 = 8{,}000$$
$$\frac{90{,}000}{0.70F} \times 9{,}000 = 8{,}000$$
$$F = \mathbf{144{,}643}$$