Understanding the Basics of Home Insurance

To ensure you have the protection you need, make sure you're clear on the policy terms before you buy or renew your policy. This article provides the terminology “foundation” you need to understand the seven basic types of home insurance.

The purchase of homeowners and renters insurance usually boils down to two crucial concerns: protection and price. The decision regarding proper home insurance coverage consists of buying the right type of policy, having the proper levels of protection within that policy, including special provisions for jewelry, your home electronics, such as computers and other particularly valuable possessions, and supplementing this coverage with special protection against natural disasters that are not covered in your basic policy.

Homeowners with mortgages are required by their lenders to have home insurance. Many people may think that the policy terms required by their lenders represent "OK" levels of insurance, but this may not be true. Lenders want to make sure their exposure is covered, but that can happen without you being fully protected. Thus, it's important that you calculate your needs as well and make sure they are reflected in your coverage.

Although regulated at the state level, home insurance is more of a national product than is auto insurance, meaning you will find fewer local variations.

Seven basic policies

The seven basic kinds of home insurance policies are pretty much the same regardless of where you live. They are defined by the perils they cover:

HO-1. Basic homeowner coverage. Covers your dwelling and personal property against losses from 11 types of perils: fire or lightning, windstorm or hail, explosion, riot or civil commotion, aircraft, vehicles, smoke, vandalism or malicious mischief, theft, damage by glass or safety glazing material that is part of a building and volcanic eruption.

HO-2. Basic homeowner coverage plus. Covers dwelling and personal property against 11 perils plus six more: falling objects; weight of ice, snow or sleet; three categories of water-related damage from home utilities or appliances; and electrical surge damage.

HO-3. Extended or special homeowner coverage. Covers 17 stated perils plus any other peril not specified in your policy, except for flood, earthquake, war and nuclear accident.

HO-4. Renters' coverage. Covers only personal property from 17 listed perils.

HO-5. All risk coverage for building and personal property. This policy form isn't sold very often anymore.

HO-6. Condominium owner coverage. Covers personal property from 17 listed perils along with certain building items in which the unit owner might have an insurance interest.

HO-7. Basic older-home coverage. Covers dwelling and personal property from 11 perils. Differs from HO-1 in that it covers repairs or actual cash values, not rebuilding costs. This is for homes where some historic or architectural aspects make the home's replacement cost significantly higher than its market value.

There are variations on these policies as well. For example, landlords can buy coverage that insures only their dwelling and not its personal property (which would be covered by a tenant's renter's policy would cover). And you can get special policies to cover manufactured housing. Most homes are covered by HO-2 and HO-3 type policies.

Coverage levels

There are many special coverage provisions offered by insurers, but here are some basic questions that you should answer as part of the home insurance process:

In the event of a serious loss, let's say it's a fire that destroys the house, how would I fare? In most cases, you want to insure your dwelling and its contents for their replacement values, which likely will differ from the dwelling's market value and your personal property's depreciated cash value. You probably also should get a policy with automatic inflation adjustments so that the replacement cost keeps pace with the general level of price increases.

Standard coverage normally insures your possessions at 50% of the value of your dwelling. Many people boost this coverage to 70% or 75% with additional protection. But there are still individual limits on certain types of personal property (see below).

Free-standing structures on your property (garages, gazebos, tool sheds) are also covered, with standard protection equal to 10% of your dwelling. Trees and shrubbery normally can be replaced up to a limit of 5% of your dwelling coverage. As is the case with your personal property, you should assess your needs to determine if you want to pay extra amounts to increase these levels of protection.

Also, pay attention to what might happen if you were to lose the use of your home for an extended period. Loss-of-use provisions are important elements of homeowners' policies, and coverage levels equal to 30% or more of your dwelling's insurance aren't unusual.

If someone who is not covered on my health insurance were to suffer a serious injury in my home, and I was found liable, how would I fare? The standard level of liability protection in homeowners' policies has been $100,000, but it's rising all the time. Today, $300,000 is not an uncommon amount, and even higher levels are recommended for homeowners with significant assets to protect. In this situation, "umbrella" policies are available. These policies provide excess liability coverage on both your homeowner and automobile policies, and are not expensive. Most companies will normally require you to carry your underlying homeowner's and automobile policies with them. They also generally increase your uninsured and underinsured motorist coverage to the "umbrella" limits.

Do I have certain possessions (computer equipment, cameras, jewelry) whose replacement values far surpass normal coverage limits in my policy? Standard policies may not come near covering the replacement costs of even moderate amounts of home electronics hardware or expensive possessions. For relatively small amounts, you can purchase "riders" that will add protection to certain types of personal property. In addition, equipment related to a home-based business may not be covered satisfactorily unless you obtain additional protection.

Among the questions to ask are: Can I afford a high deductible -- say, $1,000 -- in order to save money on the policy? The differences in annual premiums between policies with deductibles of $250 (you pay the first 250 of damage, the insurer pays the rest), $500 and $1,000 may easily be worth 20% to 30% of the annual premium. So, if you can afford the expenditure, and want to place a small bet that you won't face a home-related loss, consider a larger deductible.

What other protections does my policy provide? Homeowners' policies regularly provide other types of coverage, including off-premises theft protection and unauthorized use of your credit cards. You are also covered for general negligence claims even if the conduct occurs off your property. Make sure you understand which provisions are included in the standard coverage you elect to purchase and which may require supplemental premiums.