

Cap on homeowner's insurance potentially problematic

By Ken Halliburton, President Miller Loughry Beach

A home is a large and important investment for most people. Fortunately, most will never experience the devastation of losing their home and its contents to a catastrophe.

At the same time, many people are not aware that large insurance companies have begun adding a cap to homeowner's policies that limits how much an insurance company will pay to replace the home if it is destroyed. What the insurance company pays as a claim could be substantially less than the replacement cost, leaving the homeowner responsible for any difference.

Knowing how an insurance company determines home value is important. Each home has three different values:

- **Assessed value** - the value that the local jurisdiction has determined for taxation purposes
- **Market value** - the price the home would demand on the open market
- **Replacement value**- the actual cost of time and materials to replace the structure

These values can vary widely depending upon the jurisdiction and housing market. When paying a claim, insurance companies only care about the replacement value.

Several years ago, large insurance companies noticed actual replacement value for insurance claims significantly exceeding the replacement value in the insurance policy. As a result, many of them began adding a standard 25 percent cap to homeowner's policies that limits the company's exposure to cost increases.

For example, a \$300,000 policy with a 25 percent cap would pay a maximum of \$375,000 to replace a damaged structure even if the actual replacement cost was greater.

Homeowners can take several steps to protect themselves in the event of a catastrophic loss:

- **Update your policy if it is more than five years old.** Policies often have an inflation index, but that index may not be enough to cover the inflation in building materials and costs.
- **Find out if your homeowner's policy has an insurance cap.** The industry standard is 25 percent.
- **Seek advice about switching to a policy with a true replacement guarantee if your current policy has a cap.** Some insurance companies still offer policies with no cap. These policies generally do not cost any more than policies with a cap.

We also recommend that homeowners review and, if necessary, update the contents limit of their homeowner's policies. The contents limit is the maximum insurance companies will pay in the event of a loss. The best step homeowners can take is to videotape and describe the contents of the home as they are videotaping - for example, "This is an antique chest for which we paid \$1,000 in 2003."

Ken Halliburton is President of Miller Loughry Beach. He can be reached at (615)494-9610 or by e-mail at ken.halliburton@millerloughry.com.

Miller Loughry Beach, a subsidiary of Pinnacle Financial Partners, provides a full range of insurance solutions, including personal, business and employee benefits, as part of the Pinnacle's comprehensive approach to wealth management.

The insurance product or annuity offered is not insured or guaranteed by the FDIC or any government agency. It is not a deposit or obligation of Pinnacle National Bank or any affiliate. It is not guaranteed or endorsed by Pinnacle National Bank. The value of the insurance product or annuity, if it involves an investment risk, may fluctuate; the return on the investment is not guaranteed, and loss principal and value is possible.