PAGE ONE Economics®

Focus on FINANCE

Renters and Homeowners Insurance: When the Unexpected Happens

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GLOSSARY

Coverage: How much risk or liability is protected with an insurance policy.

Credit history: A person's payment activity over a period of time.

Deductible: An amount you must pay for expenses before the insurance company pays. The deductible amount is specified by the terms of the insurance policy.

Liability: Legal responsibility.

Lawsuit: A claim by a person or entity against another person or entity brought to a court of law for legal resolution.

Loan: A sum of money provided temporarily on the condition that the amount borrowed be repaid, usually with interest.

Premium: The fee paid for insurance protection.

Probability: The likelihood or chance of an event occurring.

Rider: An optional addition to an insurance policy that adds benefits or amends the terms of the policy and may increase the premium.

Risk: The chance of loss.

"Don't Know What You Got (Till It's Gone)"
—Song written by Tom Keifer and performed by the band Cinderella

Introduction

When the 1980s band Cinderella performed "Don't Know What You Got (Till It's Gone)," they were referring to a lost love, but the idea can apply to any loss, really—including the loss of your possessions. Think about everything you own. How much would you have to pay to replace it all? Do you even know for sure what you own? Hopefully you've never experienced it, but it is possible to lose all of your belongings. In 2012, for example, many people lost their homes in Hurricane Sandy, with New York and New Jersey losing more than 600,000 housing units.[1] Those with insurance had help to replace structures and personal belongings and didn't have to pay the full amount themselves. Why? When people buy insurance, they must pay insurance **premiums**. When an insurance holder has a loss, payment is made from the pooled premiums. In this way, insurance transfers **risk** to a larger group. For example, after Hurricane Sandy, insurance holders' repair bills were paid by many people's insurance premiums, not just the premiums of those affected by the storm. With insurance, the cost to anyone insured is less than the cost of all the losses. Many types of insurance are available, with each providing specific types of **coverage**.

Property and Casualty Insurance

Property and casualty insurance includes coverage for homeowners, renters, cars, motorcycles, businesses, and much more. The "property" part is straightforward: People buy insurance to protect the value of their personal property in the event of a loss. "Casualty," on the other hand, generally refers to losses due to legal **liability**. Typically, when a person or entity faces a **lawsuit**, or in other words is sued, it's because a complaint has been made accusing the person or entity of causing harm or being negligent. For example, a homeowner with ice-coated front steps could face a lawsuit for negligence if a visitor falls and is injured. An employer who fails to provide proper safety equipment could face a lawsuit if a worker is hurt

Insurance Declaration Page		
Coverages and deductibles	**Limits**	**Premium**
Section I: Property coverages		
Coverage A: Dwelling protection (structure) • $1,000 All peril deductible	$200,000	$1,200
Coverage B: Other structures protection • $1,000 All peril deductible	$20,000	Included
Coverage C: Personal property protection • $500 Deductible • Replacement value	$100,000	$125
Coverage D: Loss of use—additional living expenses • Up to 12 months	$20,000	Included
Additional coverages: Backup of sewer and drains Rider: jewelry	 $5,000 $7,500	 $50 $100
Section II: Liability coverages		
Coverage E: Personal liability protection	$300,000 per occurrence	$50
Coverage F: Medical payments (guest medical)	$5,000 per person	$25

on the job. We'll focus on homeowners and renters coverage, but some terms are common across types of insurance and include liability, **deductible**, and premium. Being familiar with some basic insurance terms is helpful as you begin the process of shopping for and eventually buying insurance. We'll start with homeowners insurance first and then move to renters insurance (pun intended).

Homeowners Insurance

When you own a house, purchasing homeowners insurance provides protection for the dwelling and its contents in the event of a loss. In fact, if you purchase a home with a **loan**, the lender will require you to have insurance to protect the value of the home. The primary coverage of a homeowners policy generally includes the dwelling; other structures; personal property; loss of use; personal liability; and medical payments, sometimes called guest medical coverage. In addition, customers can buy **riders** to insure specific valuable items, such as jewelry, expensive art, or gun collections. Insurance companies usually offer additional coverage for sewer backups as well. Although policy options vary by company and state laws, a typical homeowners policy includes a *declaration page* that shows the coverage and dollar amounts. (See the table.)

For the coverage shown in the table, the total amount of insurance on the dwelling (Coverage A) is $200,000 with a $1,000 deductible. The policy states the coverage limits, exclusions, and any deductibles. The other structures protection (Coverage B) is 10 percent of Coverage A. Any structure not attached to the dwelling would be insured under this section. Such structures include detached garages, sheds, and even swing sets. Coverage C is for personal property, which is all your stuff—including your clothes, TV, and toaster. In the event of a loss, the insurance company would pay the replacement costs. In the example, Coverage C is 50 percent of Coverage A. Loss of use, Coverage D, would pay for a place to stay, such as a hotel, and meals if a covered loss makes a home uninhabitable. Coverage D is 10 percent of Coverage A. When a covered loss occurs, the insured could receive payments from each part of the policy to which the loss applies. Coverage E, personal liability protection, will provide funds for legal costs and any payouts if the homeowner is sued and found legally liable.

Personal liability coverage also applies to the actions of others insured by the policy, such as children. For example, say a group of children was playing backyard baseball. On a wild throw, a run scores as the errant ball sails through a neighbor's massive $5,000 picture window, shattering it into a million pieces. In this case, the cost to replace the window—the liability—would be the responsibility of the player who threw the ball or the player's parents or guardian. The person with the broken window could file a claim with the thrower's insurance company to get the window replaced.

Medical payments (or guest medical) coverage is designated to pay for injuries sustained on a homeowner's property by a guest—invited or uninvited. The inclusion of uninvited guests protects the homeowner from having to pay medical bills, say, of a salesperson injured from tripping over a flowerpot by the front door. Medical payments coverage usually has a lower dollar limit, such as $5,000. If the medical bills are greater than that, a homeowner's personal liability coverage would typically cover the rest; however, that would likely involve the injured party filing a lawsuit against the homeowner. For example, if a dog bite required surgery, the injured party might sue the homeowner to have the cost covered. The legal language in the insurance policy and the courts often determine payments in such instances. Renters insurance provides many of the same protections.

Renters Insurance

Spoiler alert! The main difference between homeowners and renters insurance is that renters insurance doesn't provide protection for the building you live in—because you don't own it. But if you're renting, will the building owner pay if your personal property becomes lost, stolen, or damaged? No (although many people incorrectly think otherwise). Building owners buy insurance for the property, and his or her personal liability and personal property if applicable, but not for the property of the tenants. For renters to have financial protection in the event of a loss, they need to have their own insurance.

If you live at home while attending any post-secondary school, your belongings will most likely be covered through your parent or guardian's policy if you are named on the policy, but check to make sure. Generally, personal property coverage is extended to your college dorm room if you are named on the policy. This coverage is generally specified as a percentage of the personal property coverage limit, for example, 10 percent of $50,000.[2] If you live off campus in a house or apartment, your personal property is generally not covered unless you buy your own renters insurance policy. Unfortunately, many people find this out the hard way—after a fire or other disaster. In fact, the majority of renters don't have renters insurance,[3] even though it is generally inexpensive compared with the cost of replacing personal belongings.

Another good reason to purchase renters (or homeowners) insurance is this: It covers your personal property *anywhere in the world* if something happens to it because of a covered loss or theft. Renters (and homeowners) insurance policies, however, generally don't cover losses from floods or earthquakes.[4] Like homeowners insurance, renters insurance provides liability coverage if someone files a claim or lawsuit against you. Also similarly, you could receive additional living expenses for a place to live, in the event of a covered loss. Insurance can be thought of as a safety net: You might not need it, but if you do, it protects you from greater (financial) harm.

Insurance Companies

What's in it for insurance companies, and how do they decide whom to insure and how much to charge? Insurance companies provide coverage to their customers for a price. The hope is that the cost of claims will be less than the premiums received—so that the insurance company will make a profit. The price of insurance is based on the **probability** of an event occurring that would cause the insurance company to have to pay a claim. Actuaries, who work for insurance companies, calculate these odds. Then, underwriters, who also work for insurance companies, evaluate properties, conditions, and applicants to determine good and bad risks for their companies.

When evaluating risk for building or personal property coverage, underwriters look at the building's location, when and how it was built, the type of construction, the building's condition, and even how close the building is to a fire hydrant. When evaluating applicants, underwriters generally assess a person's past insurance claims

TIP

Insurance professionals recommend you periodically take a video of all of your belongings so you know exactly what you have. They also recommend that you keep records and receipts (to prove value). If you store the information electronically, you'll have easy access to it if you need it.

(loss history), previous and current insurance coverage, and **credit history**.

People usually buy insurance from an agent or an insurance company's website. Most often, insurance companies offer discounts to customers who purchase renters or homeowners along with auto insurance. It pays to shop around and weigh your options before you make a choice.

Conclusion

It's impossible to anticipate if you'll ever need insurance. When you have it, however, your risk is shared. Insurance companies study the probabilities and offer coverage that could save you money in the long run. If you shop around, buy the insurance right for you, and keep good records, you'll be better prepared if the unexpected happens. ■

Notes

[1] Gibbens, Sarah. "Hurricane Sandy Explained: Superstorm Sandy Was Actually Several Storms Wrapped Together, Which Made It One of the Most Damaging Hurricanes Ever to Make Landfall in the U.S." *National Geographic*, February 11, 2019; https://www.nationalgeographic.com/environment/natural-disasters/reference/hurricane-sandy/.

[2] Adams, Laura. "Do College Students Need Renters Insurance? Find Out What Renters Insurance Covers for College Kids and When Getting a Policy Is Worth It." *U.S. News & World Report*, August 7, 2017; https://money.usnews.com/money/blogs/my-money/articles/2017-08-07/do-college-students-need-renters-insurance.

[3] Dowdy, Landon. "Renting Your Place? Skipping This Could Cost You." *CNBC*, August 24, 2017, update; https://www.cnbc.com/2015/02/24/nials-rent-but-lack-renters-insurance.html.

[4] Adams, 2017. See footnote 2.

Name______________________________________ **Period**________

Federal Reserve Bank of St. Louis *Page One Economics*®:

"Renters and Homeowners Insurance: When the Unexpected Happens"

After reading the article, answer the following questions:

1. Which term refers to the payment for insurance coverage?
   a. Rider
   b. Premium
   c. Deductible
   d. Credit

2. Which statement about homeowners insurance is true?
   a. Homeowners insurance will not provide protection from certain types of disasters.
   b. Lenders do not usually require homeowners insurance on properties with outstanding loans.
   c. In a typical homeowners policy, there is no coverage for living expenses if the home is uninhabitable.
   d. Homeowners insurance provides legal protection against lawsuits stemming from car accidents as well as incidences occurring on one's property.

3. Which coverage is included in homeowners insurance but not in renters insurance?
   a. Liability
   b. Additional living expenses
   c. Dwelling
   d. Medical expenses

4. In the homeowners policy example, personal property protection (Coverage C) is ____________of dwelling protection (Coverage A).
   a. 20 percent
   b. 30 percent
   c. 40 percent
   d. 50 percent

5. Which coverage in a typical homeowners or renters insurance policy is generally optional?
   a. Personal liability
   b. Medical payments
   c. Personal property
   d. Riders

6. Which statement is most accurate?
    a. Your family's homeowners or renters insurance will cover your personal property while you're in college regardless of where you live.
    b. Your family's homeowners or renters insurance will usually cover your personal property if you're living in a dorm.
    c. Your family's homeowners or renters insurance will not cover your personal property while you're in college.
    d. Your family's homeowners or renters insurance will cover your personal property if you live in an off-campus apartment.

7. Which statement is true?
    a. In the event of a fire in an apartment building, the building owner would have insurance to pay for tenants' personal property.
    b. Unlike homeowners insurance policies, renters insurance policies do not include medical payments coverage.
    c. Underwriters evaluate buildings for risk, but not people.
    d. Renters insurance covers your personal property anywhere in the world.

8. Which statement best describes how insurance works?
    a. Insurance companies borrow money from banks when they have to pay claims to policyholders.
    b. Insurance lowers the individual effects of financial loss by spreading the risk to a larger group.
    c. Insurance companies collect and hold a customer's premiums and pay claims from that money in the event that the customer has a loss.
    d. Insurance companies change the coverage types offered on policies based on an individual's loss history.

9. The majority of renters purchase renters insurance.
    a. True
    b. False

10. Which statement is true?
    a. Insurance companies assess a person's credit history, loss history, and previous and current insurance coverage.
    b. People do not usually shop for insurance on an insurance company's website.
    c. Insurance companies do not offer discounts to customers who have renters insurance along with their auto insurance.
    d. Insurance companies keep records of their customers' personal property so they know how much to pay in the event of a loss.