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The New York Times ON THE WEB

August 31, 2004

Homeowners Come Up Short On Insurance

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 the consumer's responsibility to acquire adequate coverage.

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