

# Chapter 8

## Homeowners Insurance: Section I Coverages

### ■ Overview

With this chapter we begin our study of property and liability insurance contracts. The first coverage we will examine is a popular personal lines coverage, homeowners insurance. Homeowners insurance is called a “package policy” because it combines more than one line of coverage in a single contract. A variety of homeowners forms are available, providing coverage for homeowners, renters, and condominium owners. Because of its widespread use, we will examine the Insurance Services Office (ISO) Homeowners 3 contract in greater detail. Section I of the homeowners policy provides coverage for damage to the dwelling, damage to other structures, losses to personal property, and loss of use coverage if an insured peril makes the property unusable. Section II of the homeowners policy (covered in Chapter 9) provides personal liability insurance and medical payments to others coverage.

### ■ Learning Objectives

After studying this chapter, you should be able to:

- Identify the major homeowners policies for homeowners, condominium owners, and renters.
- Explain the major provisions in Section I of the Homeowners 3 policy, including:
  - Section I property coverages
  - Section I perils insured against
  - Section I exclusions.
- Given a specific property loss situation, explain whether the Homeowners 3 policy would cover the loss.
- Explain the insured’s duties after a loss occurs.
- Explain and give an illustration of the loss settlement provisions in the Homeowners 3 policy.
- Define the following:

Additional living expense  
Appraisal clause  
Extended replacement cost endorsement  
Fair rental value  
Guaranteed replacement cost  
Homeowners 2 (broad form)  
Homeowners 3 (special form)  
Homeowners 4 (contents broad form)  
Homeowners 5 (comprehensive form)

Homeowners 6 (unit owners form)  
Homeowners 8 (modified coverage form)  
Liberalization clause  
Loss to a pair or set  
Mortgage clause  
Proximate cause  
Replacement cost  
Schedule

## ■ Outline

### I. Homeowners Insurance

- A. Eligible Dwellings
- B. Overview of Homeowners Policies
  - 1. HO-2 (Broad Form)
  - 2. HO-3 (Special Form)
  - 3. HO-4 (Contents Broad Form)
  - 4. HO-5 (Comprehensive Form)
  - 5. HO-6 (Unit-Owners Form)
  - 6. HO-8 (Modified Coverage Form)

### II. Analysis of Homeowners 3 Policy (Special Form)

- A. Persons Insured
- B. Section I—Coverages
  - 1. Coverage A: Dwelling
  - 2. Coverage B: Other Structures
  - 3. Coverage C: Personal Property
  - 4. Coverage D: Loss of Use
  - 5. Additional Coverages
- C. Section I—Perils Insured Against
  - 1. Dwelling and Other Structures
  - 2. Personal Property
- D. Section I—Exclusions
- E. Section I—Conditions
- F. Section I and II Conditions

## ■ Short Answer Questions

1. Homeowners insurance is a multiple-line policy. What three types of coverage are provided through a homeowners policy?

2. Besides the living units insured, what are the major differences between the current homeowners forms?

3. What persons are insured under Section I of the Homeowners 3 policy?

4. What four coverages are provided under Section I of the Homeowners 3 contract?





11. Explain the purpose of the appraisal clause and the loss to a pair or set clause.

## ■ Multiple Choice Questions

*Circle the letter that corresponds to the BEST answer.*

1. Which statement(s) is(are) true with regard to Section I of an unendorsed Homeowners 3 policy?
  - I. Damage to the dwelling and other structures by an insured peril is usually settled based on actual cash value.
  - II. Damage to personal property by an insured peril is settled based on replacement cost.
  - (a) I only
  - (b) II only
  - (c) both I and II
  - (d) neither I nor II
2. Coverage D under Section I of the Homeowners 3 policy provides coverage for:
  - (a) personal property
  - (b) loss of use
  - (c) the dwelling
  - (d) other structures
3. Under the Homeowners 3 policy, personal property is insured against damage from all of the following perils EXCEPT:
  - (a) fire
  - (b) earthquake
  - (c) windstorm
  - (d) explosion
4. To determine if a covered peril is the cause of loss, insurers check to see if there is an unbroken chain of events between the occurrence of a covered peril and the damage to property. This unbroken chain of events is called:
  - (a) prohibited use
  - (b) the pair or set clause
  - (c) proximate cause
  - (d) subrogation

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5. Which statement(s) is (are) true with regard to homeowners insurance?
- I. The homeowners policy can be assigned validly with the insurer's written consent.
  - II. The insurer has the right to repair or replace damaged property with like property instead of making a cash settlement.
- (a) I only
  - (b) II only
  - (c) both I and II
  - (d) neither I nor II
6. The Homeowners 4 (HO-4) policy is specifically designed for:
- (a) owners of private dwellings
  - (b) renters
  - (c) condominium unit owners
  - (d) homes that have a replacement cost exceeding the market value
7. The mortgagee has an insurable interest in a home because:
- (a) the mortgagee loaned money for the purchase of the home and the home is collateral for the loan
  - (b) the mortgagee is the insurer writing coverage on the home
  - (c) the mortgagee purchased the home and resides in the home
  - (d) none of the above
8. A rapidly-spreading fire endangered Tom and Claire MacKenzie's home. They wanted to stay to protect the home, but a fire marshal ordered them to leave. Which statement is true regarding Tom and Claire's lodging expenses?
- (a) Lodging expenses are not covered unless their home is actually damaged.
  - (b) Lodging expenses are covered under Coverage D's "additional living expenses."
  - (c) Lodging expenses are covered under Coverage D's "fair rental value."
  - (d) Lodging expenses are covered under Coverage D's "prohibited use."
9. Which statement(s) is(are) true with regard to an unendorsed Homeowners 3 policy?
- I. The dwelling and other structures are covered on a direct physical loss not excluded basis.
  - II. Personal property is covered on a direct physical loss not excluded basis.
- (a) I only
  - (b) II only
  - (c) both I and II
  - (d) neither I nor II
10. All of the following are additional coverages provided under Section I of the Homeowners 3 policy EXCEPT:
- (a) debris removal
  - (b) reasonable repairs
  - (c) medical payments to others
  - (d) property removal

11. The Homeowners 6 (HO-6) policy is specifically designed for:
- (a) general homeowners use
  - (b) renters
  - (c) condominium unit owners
  - (d) homes that have a replacement cost exceeding the market value

## ■ True/False

*Circle the T if the statement is true, the F if the statement is false. Explain to yourself why a statement is false.*

- T F 1. Theft of personal property by an insured is excluded from coverage under the Homeowners 3 policy.
- T F 2. In the event of loss to one piece of a pair or set, the insurer must pay the replacement cost of a complete pair or set.
- T F 3. If more than one homeowners policy covers a loss, liability is determined on a pro-rata basis.
- T F 4. The homeowners policy provides coverage for damage to property, personal liability, and medical payments to others.
- T F 5. The appraisal clause explains how a settlement is determined if the insurer and insured cannot agree on the value of a covered loss.
- T F 6. Family pets are covered under Section I the homeowners policy.
- T F 7. If a homeowner rents a room above the garage to a tenant, and the room cannot be used after a fire damages the garage, lost rent is covered under Coverage D—Loss of Use.
- T F 8. Property removed from the premises because it is endangered by an insured peril is covered on a named-perils basis.
- T F 9. Ordinary wear and tear and gradual deterioration of building materials are excluded under Coverage A.
- T F 10. A detached garage is covered under Coverage A—Dwelling.
- T F 11. Deductibles are not used in homeowners insurance.

## ■ Problems

1. Tom and Wendy Williams purchased an HO-3 policy with \$150,000 in coverage on the dwelling. Ignoring “additional coverages,” what is the most their insurer will be required to pay as a result of a single property loss occurrence? Remember to consider other structures, personal property, and additional living expenses.



## Case 2

Rachel and Ted Miller own a home insured by an HO-3 policy. Last Saturday, a spark from the fireplace in the family room ignited the carpet. Before the fire was extinguished, the home was approximately 40 percent destroyed. Rachel and Ted phoned their agent, gave the agent an address where the insurer could send the check, and then left town for an extended European vacation. In what ways are the Millers endangering their right to recover from their insurer by not following policy conditions?

## ■ Solutions to Chapter 8

### Short Answer Questions

1. The three types of coverage provided through a homeowners policy are: property coverage (dwelling, other structures, personal property, and loss of use), personal liability insurance, and medical payments to others. The latter two coverages are discussed in Chapter 9.
2. The HO-2 (Broad Form) insures the dwelling, other structures, and personal property against losses from a list of specified perils.

The HO-3 (Special Form) insures the dwelling and other structures against risk of direct loss to property. All physical damage losses are covered unless specifically excluded. Personal property is covered against loss from the same perils listed in the HO-2 policy.

The HO-4 (Contents Broad Form) is designed for renters. This policy covers a tenant's personal property against loss or damage from the same perils listed in the HO-2 policy.

The HO-5 (Comprehensive Form) provides open-perils ("all-risks") coverage on the dwelling and other structures, and on the personal property.

The HO-6 (Unit-Owners Form) is designed for the owners of condominium units and cooperative apartments. The condominium association carries insurance on the building and other property owned in common by the owners of different units. The HO-6 covers the personal property of the insured for the same perils as the HO-2.

The HO-8 (Modified Coverage Form) covers losses to the dwelling and other structures based on the amount required to repair or replace property using common construction materials and methods. It is designed for older homes having a replacement cost exceeding market value. The perils insured against are more limited than under the HO-2 form.

The Section II coverages, Personal Liability and Medical Payments to Others, are identical under the various homeowners forms.

3. The persons insured under Section I of the HO-3 coverage include: the named insured and spouse (if a resident of the named insured's household), relatives residing in the named insured's household, children attending college full-time and temporarily away from home, and other persons under age 21 in the care of the insured (e.g., foster children and foreign exchange students).
4. Section I of the HO-3 policy provides four coverages. Coverage A insures against damage to the dwelling. Coverage B insures against damage to other structures, such as a detached garage, tool shed, or stable. Coverage C is protection against damage to personal property. Coverage D provides loss of use coverage in case the property cannot be used because of loss caused by a covered peril.
5. The coverage is written under both an all-risk (direct physical loss not excluded) basis and a named-perils basis. The dwelling and other structures are insured against the risk of direct physical damage to property except for losses that are specifically excluded. The personal property coverage is written on a named-perils basis.
6. Additional coverage is provided for debris removal, reasonable repairs, trees/shrubs and other plants, fire department service charges, property removal, credit card forgery and counterfeit money, loss assessments, certain collapse losses, glass or safety glazing material, landlord's furnishings, ordinance or law, and grave markers.
7. The insured perils under Coverage C include: fire or lightning, windstorm or hail, explosion, riot, civil commotion, aircraft, vehicles, smoke, malicious mischief, theft, falling objects, weight of ice or sleet or snow, accidental discharge or overflow of water or steam; sudden and accidental tearing apart, cracking, burning, or bulging of a steam, hot water, air conditioning, or automatic fire protective sprinkler system, or from within a household appliance; freezing of a plumbing, heating, air conditioning, or automatic fire sprinkler system, or of a household appliance; sudden and accidental damage from artificially generated electrical current, and volcanic eruption.
8. In addition to the specific exclusions, the general exclusions are: ordinance or law, earth movement, water damage, power failure, neglect, war, nuclear hazard, intentional loss, governmental action, weather conditions, acts or decisions, and faulty or inadequate planning and design.
9. Personal property losses are settled based on actual cash value. The insured can add an endorsement to change the coverage to replacement cost if desired. Losses to the dwelling and other structures usually are paid on the basis of replacement cost. If the insured carries coverage equal to at least 80 percent of the dwelling's replacement cost at the time of the loss, the full replacement cost is paid with no deduction for depreciation up to the limits of the policy. If coverage that is less than 80 percent of the replacement cost is in force at the time of the loss, the insured receives the greater of the actual cash value of the loss or the ratio of the amount of insurance carried to 80 percent of replacement cost, multiplied by the amount of the loss.
10. The mortgage clause is designed to protect the mortgagee's insurable interest. The mortgagee is usually a lending institution that made a loan to the mortgagor so the property can be purchased. As the property is collateral for the loan, the mortgagee is harmed if the property is damaged. Under the mortgage clause, the mortgagee is entitled to receive a loss payment from the insurer to the extent of the mortgagee's insurable interest, regardless of policy violations. So if a mortgagor violates the provisions of the policy, the insurer must still pay the mortgagee to the extent of the mortgagee's insurable interest.

11. Although the insurer and insured may agree that a covered loss has occurred, they may disagree about the value of the covered loss. The appraisal clause is designed to predetermine how such valuation disputes will be settled. Each party names an appraiser and the appraisers select an umpire. If the appraisers cannot settle the dispute, differences are submitted to the umpire who renders a decision.

If the loss is damage to a portion of a pair or set of items, the insurer can elect either to repair or replace that portion of the pair or set, or to pay the difference between the actual cash value of the property before and after the loss occurred. Through this clause, the insurer limits its liability and is not responsible for replacing the entire pair or set because one portion was damaged or destroyed.

### Multiple Choice Questions

1. (d) Neither statement is correct. Losses to the dwelling and other structures usually are settled on a replacement cost basis. Losses to personal property are settled based on actual cash value.
2. (b) Coverage D is for loss of use. If an insured peril makes the property unusable, Coverage D responds.
3. (b) Earthquake is excluded under Section I of the homeowners policy.
4. (c) This unbroken chain of events is called proximate cause. There must be proximate cause between the covered peril and the loss to property for the policy to respond.
5. (c) Both statements are true. The insurer must approve an assignment for it to be valid. The insurer has the right to repair or replace the property rather than to make a cash settlement.
6. (b) The HO-4 policy is also called the “contents form”, as renters do not insure the structure, only their personal property.
7. (a) The mortgagee loaned money for the purchase of the home. The mortgagee has an insurable interest because the home is usually pledged as collateral for the loan. If the home is damaged, the collateral is impaired.
8. (d) The lodging expenses are covered under Coverage D’s “prohibited use” coverage. In this case, an insured peril threatened the home, and the residents evacuated because a civil authority ordered them to leave.
9. (a) Only the first statement is true. The all-risk (direct physical loss not excluded) coverage applies to the dwelling and other structures only. Personal property is covered on a named-perils basis.
10. (c) Medical payments to others coverage is provided under Coverage F in Section II of the policy. All of the other choices are additional coverages under Section I.
11. (c) The Homeowners 6 (HO-6) policy addresses the specific needs of condominium owners.

**True/False**

1. **T**
2. **F** The insurer can elect either to repair or replace any part of the pair or set, or pay the difference between the actual cash value of the property before and after the loss.
3. **T**
4. **T**
5. **T**
6. **F** Pets are specifically excluded from coverage under Section I.
7. **T**
8. **F** Property removed because of an insured peril is covered on an all-risk basis.
9. **T**
10. **F** A detached garage would be covered under Coverage B—Other Structures. If the garage is connected to the home, it is covered under the dwelling coverage.
11. **F** Deductibles are used with the dwelling, other structures, and personal property coverages. The type of deductible used is a straight deductible.

**Problems**

1. There may be more coverage available under the homeowners policy than you realize. Under the worst case scenario, there would be a complete loss of property (dwelling, other structures, and personal property), and the maximum additional living expenses would be required. The insurer would pay up to:

Coverage A—Dwelling	\$150,000
Coverage B—Other Structures (10% of A)	\$ 15,000
Coverage C—Personal Property (50% of A)	\$ 75,000
Coverage D—Loss of Use (30% of A)	\$ 45,000
Total	\$285,000

2. As Gail's policy does not include a personal property replacement cost endorsement, this personal property loss is settled according to actual cash value (ACV):

$$ACV = \text{Replacement Cost} - \text{Depreciation}$$

$$ACV = \$600 - (\$600 \times 20\%)$$

$$ACV = \$480$$

Gail will collect \$480 from her insurer, assuming no deductible.

3. Under the Homeowners 3 policy, if less than 80 percent of the replacement cost of the dwelling is carried, the insured receives the larger of the following two amounts:

(1) Actual cash value, or

(2) 
$$\frac{\text{Amount of Insurance Carried}}{80\% \times \text{Replacement Cost}} \times \text{Loss}$$

The actual cash value of the loss is:

$$ACV = \$16,000 - (\$16,000 \times 25\%)$$

$$ACV = \$12,000$$

Under the alternative settlement method:

$$\frac{\$140,000}{80\% \times \$200,000} \times \$16,000 = \$14,000$$

Roberto and Elena will receive \$14,000 from their insurer as the replacement cost settlement exceeds the actual cash value settlement.

## Case Applications

### Case 1

As fire is not excluded under the Homeowners 3 (HO-3) dwelling coverage, the damage to the attached garage is covered. The lost rent is also covered under Coverage D—Loss of Use. The stolen property is covered, however there are dollar limits of liability that apply. The damage to the racing bike is covered under the personal property coverage as “vehicles” is a named peril. Unfortunately for the Foresters, damage to the foundation of their home caused by an earthquake would not be covered. Earth movement is excluded under Section I of the HO-3. Earthquake coverage can be added through an endorsement.

### Case 2

Insurance contracts are conditional. The insurer’s promise to indemnify is conditional upon the insured abiding by the terms of the contract. After a loss occurs, certain duties are required. Although the Millers gave notice of the loss, their assistance with loss settlement ended there. They are also required to protect the property from further harm, to prepare an inventory of the property, to exhibit the property, and to file proof of loss. In addition, their “send us the check” attitude is presumptuous. Losses are settled at the insurer’s option. If the claim is covered, the insurer decides whether to make a cash settlement or to repair or replace damaged property with like property.