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- > How To Sell
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- > Navigate the Deal
- > Place Ad

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- > Search
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- > Search
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HOUSING SCENE

Don't reduce your property insurance coverage to reflect lower home values

Experts say it costs more to rebuild than it does to start from scratch, so the market value of a house doesn't indicate the amount of insurance you need.

By Lew Richman
 June 7, 2009

Reporting from Washington -- There are a number of steps every homeowner should take to lower the cost of property insurance. But reducing the amount of coverage to match today's lower values is probably not one of them.

Because it costs more to rebuild than it does to start from scratch, the market value of a house is not a reliable indicator of the amount of insurance you need. Too little coverage and your policy may not assume the cost to return your place to its original condition if needed.

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"There has been a lot of noise lately around market values, but market value and the cost to rebuild are two totally different things," said Elaine Baisden, vice president of national property for Travelers Cos., the Hartford, Conn.-based property casualty insurer. "So lowering policy limits could leave you underinsured."

Despite the downward spiral in housing prices, home repair costs increased nearly 4% nationally, according to Xactware, whose software products estimate building and repair costs. Marshall & Swift, an authority on building-cost data, says it can cost as much as 30% more to rebuild a house as opposed to building a new one.

Reconstruction costs are greater because the process usually involves the demolition and removal of damaged property. On-site mobility often is limited by the need to work around existing landscaping, power lines and other buildings. There are no economies of scale like there are when building row upon row of houses. Then there's the issue of newer, often more rigid building codes that might have to be met.

Market value, on the other hand, is often influenced by factors that have absolutely nothing to do with the cost to rebuild -- the quality of nearby schools, for example, the local tax base or the proximity to rapid transit.

Value also is affected by the cost of the land on which the house sits, and that is something you should factor in when considering how much coverage to carry.

Typically, the building lot accounts for 25% of a home's value. But you can get a better reading from your tax bill, which usually separates the value of the land from the value of the house. You shouldn't use the property's assessed value to determine how much coverage you need, but you can use the percentage ratio of the lot to the total to at least get an idea of what's needed.

Still, it's probably not a good idea to arbitrarily make these kinds of decisions without first sitting down with your agent and discussing your needs. The wrong choice could prove to be an expensive one, Travelers' Baisden said.

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"Home insurance limits are in place to financially protect your family should something go wrong," she said. "If there's a fire or a significant weather event, you want to make sure you have enough coverage to rebuild your home in its entirety."

How to save

Here are some other steps you can take to save money while still protecting what may be your most valuable asset.

* **Check your credit records.** For years, insurers based their rates mainly on the location and age of the property and its distance from the nearest firehouse. Now, like mortgage lenders and other credit issuers, they "score" policyholders based on information in their credit histories.

It's a controversial practice, but insurers maintain that insurance scores are highly predictive of risk. Some use scoring only when other factors suggest that you are likely to file more claims, but others use it more extensively as both an underwriting tool and a mechanism for setting rates.

Whether you agree with the practice or not, it is important to pay your bills on time and make sure that there are no errors in your credit records.

* **Avoid nuisance claims.** The more claims you file, the more you are going to be charged, even if the claims are legitimate. So use your coverage for its intended purpose -- to protect against losses from which you cannot recover on your own -- and take care of the minor incidents yourself.

* **Shop around.** Prices vary from company to company. You won't be able to negotiate rates, but you may be able to lower your costs by comparison shopping. Premiums can vary substantially from one insurer to the next.

Although price is important, there are other factors to consider when choosing an insurer. You want a company that's financially stable, and an agent who takes the time to answer all your questions. And make sure that the company isn't prone to cutting loose anyone and everyone who files a claim.

You can check the financial health of the various carriers with rating companies such as A.M. Best and Standard & Poor's. To get an idea about service, talk with friends and relatives about their experiences, or consult consumer guides (such as Consumer Reports) that rate insurers every few years on readers' overall satisfaction with their companies.

* **Raise your deductible.** A deductible is the amount you pay toward a loss before your coverage kicks in. The higher the deductible, the lower the premium.

According to the Insurance Information Institute, an industry-supported nonprofit communications organization, bumping the deductible from \$250 to \$500 could cut your costs 12%. You could save as much as 25% by jumping to a \$1,000 deductible, and up to 30% by going to \$2,500.

But since you will be self-insuring, be careful. Don't go so high that you don't have the cash reserves to cover your share of the loss.

* **Look for discounts.** It may be possible to lower your costs by buying all your insurance from the same company. Some insurers will cut their premiums up to 15% if you buy two or more policies from them. But be sure that the combined price is lower than buying the same coverage from competing companies.

Other discounts abound. You may get a break of up to 10% if you're a longtime policyholder, say, for six years or more. And if you are over 55 and retired, you may qualify for a senior discount under the theory that since you're now home more, there's less chance of a major loss because you will be there to catch the fire or leak before it gets out of hand.

You usually can obtain a premium reduction ranging from 5% to 25% if you have protective devices such as burglar alarms or even deadbolt locks.

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