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Technical Report

Understanding the Texas Homeowner's Insurance Policy

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Foreword

The Real Estate Center first published this report describing the Texas Homeowners Policy for homeowner's insurance in June 1987. Three years later on October 1, 1990, the policy was changed by the State Board of Insurance. This publication has been revised to accommodate the changes.

The reasons for the changes were twofold. First, the State Board of Insurance wanted to make the policy more readable. The revised policy contains 466 fewer words and has 227 more sentences. The tested educational level needed to understand the policy was reduced from 9.3 years to 6.7 years.

Both word reduction and enhanced readability resulted, in part, from an added definition section. Words such as *insured, residence premises* and *property damage* were defined. To alert the reader, the defined words are underlined in the text of the policy and printed in boldface type. These definitions are reproduced in Appendix A of this report.

Second, the State Board of Insurance implemented substantial changes to the policy. The former policy specified three types of insurable property: the dwelling (Coverage A), unscheduled personal property (Coverage B) and scheduled personal property (Coverage C). The revised policy:

- dropped Coverage C. Now, Coverage C property is handled by specific endorsements.
- renamed Coverage B property as *personal property,* from *unscheduled personal property.*
- renamed *detached structures.* Now they are called *other structures,* under Coverage A property.
- renumbered all the policy endorsements. Some were dropped. Some were renamed. New ones were added.
- expanded the parties insured by the policy to include persons under 21 years of age in the care of someone who is a member of the insured's household.
- expanded coverage for personal property to include, on request, that of employees who are doing household chores and repairs for the named insured.

This report is intended to help laypersons understand the Texas Homeowners Policy. **It is for information only and is not a substitute for competent legal counsel nor advice from an expert in the field.**

Most people have a homeowner's insurance policy, but few understand its coverage, conditions and exclusions. Often, the homeowner learns about specific coverage only after a casualty. To avoid this predicament, homeowners may wish to reexamine their policies. The insurance contract—the policy—is complex, and the layperson may need assistance in interpreting and understanding its provisions. This report is designed to provide such assistance.

To understand a policy's provisions, the homeowner needs to know a few general principles of property insurance.

First, insurance may be purchased to cover two basic risks: casualty and liability. A casualty (or loss) occurs when a sudden, unexpected or unusual event such as fire, lightning, windstorm or theft damages or destroys property. A liability (or loss), on the other hand, occurs when a property owner is legally obligated to protect another person from injury or another's property from damage. Insurance may be solely a casualty policy, solely a liability policy or a combination of the two. This report deals exclusively with casualty (or property) insurance.

Second, to obtain either casualty or liability insurance, the purchaser must have an insurable interest in the property. An **insurable interest** arises when the purchaser would suffer financial loss if the property were lost or damaged or if he or she is legally liable for an injury to another or to another's property.

Insurable interest is evident when insured property is leased to a third party. Here the owner's (or lessor's) insurance limits coverage solely to the owner's property. None is extended to the renter's (or lessee's) property because the owner has no insurable interest in it.

Renters need their own insurance to protect personal property. A **Tenants Homeowners Policy,** like a Texas Homeowners Policy, can be purchased. The policy protects the tenant from casualty losses, provides liability coverage and even affords additional living expenses should a catastrophe force the tenant to live elsewhere temporarily.

Third, in Texas, all homeowners' policies are promulgated by the State Board of Insurance. With few exceptions, there can be no difference between policies issued by different carriers; **all policies are alike.** Even the available policy endorsements are the same.

Fourth, the maximum rate a carrier can charge for issuing a policy is regulated by the State Board of Insurance. However, the issuing companies may request approval to deviate below the state-set rate. The deviations are granted on a year-by-year basis. The State Board of Insurance publishes the approved deviations, listing companies in alphabetical order. The Property Deviation List can be ordered by writing the State Board of Insurance, Property Division (011-1), 1110 San Jacinto, Austin, Texas 78701-1998.

The policy rates set by the State Board of Insurance depend on the amount of insurance purchased, the deductibles chosen and the types of endorsements added to the policy.

Fifth, because Texas homeowners' policies are alike, the purchaser must individualize the policy by choosing and purchasing needed endorsements.

Sixth, casualty insurance policies grant coverage in one of two forms or in combination: **specified peril** and **all risk.**

A specified-peril (also known as *named-peril*) policy lists or designates the types of perils (causes of loss) insured against to the exclusion of all others. With this type of policy, the purchaser must pay particular attention to the perils insured against to determine if adequate protection is provided. As a general rule, specified-peril policies provide less coverage at a lower premium than do all-risk policies.

The homeowner's policy form known as **HO-A (Limited Coverage)** grants specified-peril protection.

For example, a property owner may wish to purchase fire protection only. This would be a specified-peril policy. However, endorsements for other types of specified perils may be purchased and attached to the policy. In addition to windstorm and hail protection, coverage may be available for perils such as explosions, smoke or fire and theft.

The all-risk (sometimes called the *multiperil*) policy lists or describes the types of perils **excluded**—not insured—to the inclusion of all others. Here the purchaser must pay close attention to perils excluded to see if adequate protection is provided. The homeowner's policy form known as **HO-C (All-Risk Coverage)** grants this type of protection.

The homeowner's policy form known as **HO-B (Broad Coverage)** combines the two types of protection. Specified-peril protection is extended to the dwelling, and all-risk protection is extended to personal property. Because HO-B is the most popular form used in Texas, this report focuses on its coverage.

Seventh, the actual insurance contract has five basic parts: declarations, endorsements, perils insured against, exclusions and conditions. The policy does not package the parts neatly in these individual sections.

Declarations

The front page attached to the policy is the declaration page. It summarizes both the policy's coverage and costs, and provides a blueprint of the policy's provisions. The key to understanding a homeowner's insurance policy is the declaration page.

Nine items are referenced on the declaration page: property insured, parties covered (the named insured), issuing company (the insurer), limits of liability for each type of property insured, commencement and termination dates of the policy, deductibles, premiums and the endorsements included with the policy.

Property Insured

Two types of property are insured by the HO-B form: the dwelling (also known as *Coverage A*) and personal property (also known as *Coverage B*). The declaration page specifies the respective limit of liability (the maximum monetary coverage) and the deductible for each.

Coverage A (Dwelling)

Coverage A of the policy insures the buildings on the residence premises. The term *residence premises,* in urban areas, means the real property on which the residence sets. Generally, this is described by lot and block number. The term may have a different meaning if the purchaser is buying condominium insurance, farm and ranch insurance (for a home outside a city) or mobile home insurance. However, these categories are beyond the scope of this report.

As will be discussed later, the major protection under Coverage A extends to the dwelling. The term *dwelling,* according to the policy, means the structure being occupied as a residence and all the structures attached to it, such as a garage.

For homebuyers and persons building a home, the dwelling need not be occupied. The policy insures any building the insured (the person covered by the policy) intends to occupy as a dwelling within 60 days after the policy commences.

An additional 10 percent of the limit of liability for Coverage A extends to the other structures on the residence premises set apart by clear space. These structures (referred to as *other structures*), such as detached garages and storage sheds, may be connected to the dwelling by a fence, utility line or similar connection. However, the detached structures may not be used for commercial, manufacturing or farming purposes nor may they be wholly rented to others except as a private garage.

In Texas, the type of coverage extended to detached structures is known as *additional insurance.* Additional insurance *increases* the policy's limit of liability. For example, a homeowner having a $100,000 limit of liability for Coverage A for the full replacement value of the dwelling automatically receives an additional $10,000 coverage for detached structures. In the event of a total loss of all buildings, the homeowner would receive a total of $110,000, less the deductibles. This assumes, of course, that the value of the buildings equaled or exceeded the amount of the loss.

Five percent of the limit of liability for Coverage A extends to the loss of trees, shrubs, plants and lawns on the residence premises. The loss, however, must be caused by "a peril insured against." These are sometimes called *insured perils* and include fire, lightning, explosion, aircraft, vehicles not owned or operated by a resident of the residence premises, vandalism and malicious mischief, riot and civil commotion, or theft or attempted theft. Losses caused by weather, such as windstorms or freezes, are excluded, as are trees, shrubs, plants and lawns grown for business purposes.

Losses from an insured peril in excess of $250 per tree, shrub or plant, including the cost of its removal, are uninsured. No deductible applies to this coverage. Otherwise, the limited coverage might be more than offset by the deductible. However, there is no limit on the cost of removing the debris from a tree that has damaged insured property as long as an insured peril caused the tree to fall.

The coverage for trees, shrubs, plants and lawn is not additional insurance. There is no 5 percent increase in Coverage A's limit of liability extended to these losses.

Coverage B (Personal Property)

Generally, personal property consists of all items not firmly affixed to the ground. This includes wearing apparel, furniture, tools, appliances, books and electronic items such as televisions, stereo systems and radios.

Personal property worn or used by an insured while on the residence premises is covered up to the policy's limit of liability as shown on the declaration page for Coverage B. This includes window and wall air-conditioning units, as defined by the policy. The same coverage extends to the personal property of others while on the residence premises when requested by an insured, except for that of renters and boarders.

Personal property receives broad coverage. All the insured's personal property meeting the policy's definition and not explicitly excluded is covered up to the policy's limit of liability for an insured peril. There is no itemized list.

Wall-to-wall carpeting receives dual treatment. The carpet's value is used to calculate the value of the dwelling for Coverage A. However, the payment for any loss or damage comes from Coverage B.

The policy also includes *off-premises coverage* as additional insurance for the personal property owned, worn or used by an insured anywhere in the world. The off-premises coverage is limited to

$1,000 or 10 percent of the policy's limit of liability for Coverage B, whichever is greater, less the deductible. No off-premises coverage is extended to the property of others except that of a residence employee when:

- the coverage is requested by an insured,
- the personal property is in control of the employee and away from the employee's residence and
- the employee is performing work for an insured.

The term *residence employee* means an employee of the insured who performs duties related to the ownership, maintenance or use of the residence, including the maintenance or use of a motor vehicle. The term does not include the duties related to a business of the insured.

Special Limits of Liability for Personal Property

A maximum recovery is placed on four categories of personal property. The limits are not additional insurance. The insured may receive additional coverage for the personal property by purchasing specific endorsements.

Listed below are the four categories and their insured limits, the respective endorsements and the available additional coverage.

1. **Money and Bank Cards.** A $100 limit is placed on money or numismatic property (coins, medals and similar items) regardless of the cause of loss. However, for bank fund transfer cards registered to an insured, the $100 limit applies only to a loss by theft or from an unauthorized use.

   Endorsement HO-112 (formerly HO-315) may increase the coverage an additional $400 for a maximum coverage of $500.

2. **Bullion and Valuable Papers.** A $500 limit is placed on gold or silver bullion, manuscripts, notes, securities, stamps, philatelic property (postage stamps, revenue stamps, stamped envelopes, postmarks, postal cards and similar material relating to postal or fiscal history), accounts, bills, deeds, evidences of debt, letters of credit, passports, documents and transportation or other tickets regardless of the cause of loss.

   Endorsement HO-113 (formerly HO-315) may increase the coverage an additional $500 for a maximum coverage of $1,000.

3. **Jewelry, Watches, Furs.** A $500 limit is placed on gems, watches, jewelry or furs for a loss by theft.

   Endorsement HO-110 (formerly HO-339) may increase the coverage an additional $4,500 for a maximum coverage of $5,000. (However, to receive coverage, loss of jewelry, watches and furs must be from theft.)

4. **Business Personal Property.** A $2,500 limit is placed on business or farm and ranch property regardless of the cause of loss. There is no coverage for business personal property not on the residence premises or consisting of samples or articles for sale or delivery.

   Endorsement HO-111 (formerly HO-391) may increase the coverage an additional $2,500 for a maximum coverage of $5,000.

No specific limits are placed on guns, silver flatware, china or similar items. The insured should make sure that the limit of liability for Coverage B is sufficient to cover the loss.

Personal Property Not Insured

Eight categories of personal property are uninsured by Coverage B of the policy. These include:

1. Articles separately described and specifically insured by this policy or by other insurance.
2. Animals and birds.
3. Motor- or engine-propelled vehicles or machines designed for movement on land, including attached machinery or equipment.

Note. Vehicles and machines not subject to motor vehicle registration are covered as long as:

a. the devices and equipment are used for assisting the handicapped,

b. the vehicles or machines are used for recreational purposes while on the residence premises,

c. the farm equipment is not designed principally for use on public roads and

d. the vehicles are power mowers or golf carts.

4. Trailers, semitrailers or mobile homes.

Note. There are two exceptions in this category. Trailers and semitrailers that are designed principally for use off public roads, as well as boat trailers, are insured while on the residence premises.

5. Any device, such as aircraft, used or designed for flight, except model or hobby aircraft not used or designed to carry people or cargo.

6. Any watercraft, including outboard motors and furnishings or equipment, while away from the residence premises or on water.
7. Property of roomers or tenants.
8. Property usually rented to others off the residence premises.

Parties Insured

The policy insures the property of four groups who have an insurable interest in the property: the person(s) indicated on the declaration page as the named insured; the spouse of the named insured who resides in the same household; the relatives of the persons in the first two groups who reside in the same household; any person(s) under the age of 21 in the care of anyone in the first three groups.

On request by an insured, either before or after a casualty, the personal property of others, except roomers and renters, may receive coverage while on the residence premises. Likewise, on request, the personal property of a residence employee may receive coverage in the circumstances described earlier.

If a mortgage exists against the residence premises, the mortgagee (lender) automatically becomes an insured party. The lienholder is noted on the declaration page. A standard mortgage clause contained in the policy covers the mortgagee's interest. The clause provides separate agreements between the insurer and the mortgagee for the insured buildings on the residence premises. In the event of a loss, payment is made jointly to the insured and the mortgagee even if the mortgagee has commenced foreclosure proceedings. The insured and lender must then decide how to divide the payment.

It is possible for the mortgagee to receive full payment under the policy and for the insured (mortgagor) to be ineligible. This occurs when the insured breaches a condition of the policy such as failing to pay premiums or failing to file a Proof of Loss form within 91 days of a loss (see "Conditions Affecting Casualty Losses," p. 8).

All the terms and benefits of the policy apply directly to the mortgagee (and bypass the insured) when three conditions are met:

1. The insurer requests and the mortgagee pays any premiums due under the policy;
2. the mortgagee submits a signed, sworn statement of loss within 91 days after receiving notice from the insurer that no submission has been made; and
3. the mortgagee informs the insurer of any known change in ownership, occupancy or substantial change in risk.

In the event payment is made to the mortgagee because of the insured's ineligibility, the insurance company acquires certain rights against the insured under the mortgage instrument. To the extent of the payment, the mortgagee's rights under the mortgage instrument will be transferred to the insurance company.

The insurance company has another option, however. The insurer may pay off the entire existing mortgage instead of the loss due under the policy. All rights of the mortgagee under the mortgage instrument will then be transferred to the insurance company. Thereafter, the insured owes the insurance company the remaining mortgage debt.

To keep the mortgagee apprised of **cancellations,** the insurer is required to give the mortgagee a 14-day written notice of any cancellation caused by nonpayment of the premiums. A 30-day written notice is required for a cancellation for other reasons. The cancellation notices will be sent only to the mortgagee named on the declaration page, not to any successor or assignee.

If the policy is not **renewed,** the insurer will send a written notice at least 30 days before the policy expires. The notice will be sent to the mortgagee named on the declaration page.

Finally, the policy gives the mortgagee the option to terminate the policy in the event of a foreclosure. If so, the mortgagee is entitled to any unearned premiums calculated by using the customary short-rate procedures. (See page 13 for more details on the short-rate procedure.) The mortgagee *must* either credit the unearned premiums against any deficiency owed by the borrower following the foreclosure or return the uncredited premiums to the borrower.

Endorsements

Endorsements are preapproved amendments that the company will add to the policy if the purchaser requests them. With one exception, the endorsements require additional premiums.

Endorsements add flexibility to the standard homeowner's policy, enabling the purchaser to mold a policy to particular needs. For example, the purchaser may add additional coverage for certain types of personal property with limited coverage as mentioned earlier (see page 4), add windstorm coverage to greenhouses and cloth awnings and even add coverage for television and radio antennas and satellite dishes.

When the State Board of Insurance revamped the standard policy form in 1990, the endorsements also were revised. Some were dropped, others were added. All were renamed and renumbered. Presently, there are 20 endorsements that may be added to an HO-B insurance policy. These are listed by current names with their new and former numbers in Appendix B.

The endorsements listed in Appendix B indicate the extra coverage available. However, unless the homeowner understands the basic insurance coverage, he or she will not know which endorsements are needed for additional coverage. Unique circumstances should be discussed with an insurance agent.

Recent changes to two endorsements are noteworthy: HO-102, entitled "Agreed Amount on Dwellings" and HO-101, entitled "Replacement Cost for Personal Property."

The first endorsement, HO-102, pertains to Coverage A (the dwelling). As is noted under "Conditions Affecting Casualty Losses" (page 8), if the dwelling is not insured for at least 80 percent of its replacement value, the recovery under the policy may be reduced. Endorsement HO-102 removes the risk of missing the critical 80 percent replacement cost level. The insurance company agrees *in advance* that the level of insurance on the dwelling is adequate to meet the 80 percent limit. **This endorsement is free.**

The second endorsement, HO-101, pertains to Coverage B (personal property). Without this endorsement, the insured receives the **actual cash value** of any lost, stolen or damaged personal property. (The term *actual cash value* means the depreciated value of the property at the time of loss.)

With this endorsement, the insured receives the replacement value of the damaged or stolen personal property, which includes wall-to-wall carpeting and cloth awnings. However, several conditions are attached.

- The limit of liability for Coverage B must be at least 60 percent of the limit of liability for Coverage A.
- The property must be repaired, restored or replaced within 360 days after the loss. Otherwise, reimbursement will be made on the basis of actual cash value.
- The endorsement is inapplicable to property that cannot be replaced, is not maintained in good workable condition or is obsolete or useless to the insured at the time of loss.
- The endorsement is limited to $2,500 for any replacement cost to watercraft, including outboard motors.

The declaration page indicates the endorsements added to a policy.

Perils Insured Against and Deductibles

As noted earlier, there are two types of casualty insurance—specified peril and multirisk. The HO-B insurance form extends multirisk coverage to Coverage A property unless the loss is specifically *excluded* by the policy. Coverage B, on the other hand, receives specified-peril coverage unless the loss is excluded elsewhere in the policy. The specified perils insured against for personal property are reproduced in Appendix C.

Regardless of the type of coverage, the deductibles are based on the perils causing the damage or loss. A *deductible* is the amount of loss the purchaser is willing to absorb before the insurer is asked to pay. The higher the deductible, the lower the premium because the insurer assumes less risk and has lower administrative costs for processing small claims.

There are two deductibles based on the perils causing the loss. The first deductible, generally referred to as **Clause No. 1**, is for each loss to either the dwelling or personal property resulting from windstorm, hurricane, hail or wind-driven rain. The second deductible, commonly referred to as **Clause No. 2**, is for each loss to either the dwelling or personal property *not resulting* from windstorm, hurricane, hail or wind-driven rain.

When a single event causes a loss by windstorm, hurricane, hail or wind-driven rain and by lightning, the larger deductible specified in either Clause No. 1 or No. 2 applies.

Extended Coverage for Perils Insured Against

If a loss is caused by an insured peril (sometimes referred to as a *peril insured against*), coverage beyond the actual damaged or destroyed property may be available. This is known as extended coverage. There are seven categories of extended coverage contained in the policy.

Debris Removal

The insurer will pay all the expenses for removing the debris from the residence premises if caused by an insured peril. This includes debris from trees if the trees caused damage to insured property. However, this is not additional insurance.

Loss of Use of Dwelling

The policy covers the increased (or additional) living expenses caused by the residence being rendered entirely or partially untenantable (unlivable) by an insured peril. This would include the cost of staying in a hotel, motel or apartment or for renting a house. The insured could even remain on the property in a camper or trailer. These two limitations apply, however:

- The increases in living expenses must be necessary and reasonable to maintain the normal standard of living.
- The increases cannot exceed 20 percent of the limit of liability for Coverage A.

The coverage is not limited to increased living expenses. It covers also the *net loss* of the fair rental value to any part of the damaged dwelling usually rented to others. The net loss is calculated by deducting from the gross rent the related expenses that cease after the loss.

The loss-of-use payments continue during the reasonable time required to repair or replace the damaged property, even if it extends beyond the expiration of the policy. If a permanent relocation is necessary, the payments will continue for the reasonable time required to resettle the household.

The loss-of-use coverage is additional insurance to Coverage A. There is no deductible.

Reasonable Repairs

The insurer will pay the reasonable repair costs necessary to protect insured property from further damage. An insured peril must have caused the initial damage, however. This is *not* additional insurance.

Trees, Shrubs, Plants and Lawns

The insurer will pay up to 5 percent of the limit of liability for Coverage A for a loss caused by an insured peril to trees, shrubs, plants and lawns. Generally, the insurance is limited to no more than $250 per tree, shrub or plant, including the cost of renewal. This is *not* additional insurance. See page 3 for more details.

Property Removed

The insurer will pay the expenses and damages incurred for removing personal property from an insured location endangered by an insured peril. If the personal property is moved to separate locations, the coverage exists on a pro rata basis for 30 days at each location. This is *not* additional insurance.

Consequential (or Indirect) Loss Caused by Temperature Change

A consequential loss is one that results from or naturally follows another. If someone is seriously hurt in an accident, a consequential loss would be the lost wages. A direct loss would be hospital bills.

In a homeowner's insurance policy, the insurer insures two types of consequential losses to personal property.

First, if a temperature change was a direct result of physical damage to the building, the ensuing consequential damage to the personal property is covered up to the limit of liability of the policy. This is true as long as the original physical damage to the building was caused by an insured peril. There is no deductible for the coverage.

On the other hand, if a temperature change was a direct result of damage to power, heating or cooling equipment or to the connections or supply pipes thereto, the consequential damage to the personal property is covered up to $500. The original damage to the equipment, connections or supply pipes must have been caused by an insured event. This is *not* additional insurance. There is a deductible.

Automatic Removal

The Automatic Removal provisions apply if the insured should move to a new principal residence anywhere within the continental United States or Hawaii. The coverage for personal property continues at the new location for 30 days from the date the removal (moving) commenced.

There are two limitations to this coverage. First, while the property is in transit, the maximum recovery is limited to the policy's off-premises coverage. This is the greater of $1,000 or 10 percent of the limit of liability for Coverage B. Second, if all the property is not moved to the same location, a recovery during the 30-day period at any one site is prorated. The amount of recovery is determined by dividing the value of the property at the location where the loss occurred by the total value of all the insured's personal property. The resulting fraction is multiplied by the policy's limit of liability for Coverage B.

Exclusions

Exclusions represent the policy's limitations, restrictions and denials of coverage for various circumstances. As mentioned earlier, the exclusions affect both the multirisk coverage extended to the dwelling and the specified-peril coverage extended to personal property.

The Texas Homeowners Policy contains a section entitled "Exclusions," reproduced in Appendix D. The purchaser should realize that the exclusions relate primarily to the causes of the loss, not to the property damaged. For instance, losses from freezing, flooding, deterioration and animals kept by the insured are excluded.

No standard homeowner's or tenant's insurance in Texas covers damages or loss caused by rising waters. **Flood insurance is available only through the National Flood Insurance Program (NFIP).** Insurance agents licensed to sell property insurance in Texas can sell flood insurance.

The type of flood insurance coverage available in an area depends on the community's participation in the national program. Local insurance agents should have the pertinent information. If not, contact the National Flood Insurance Program, South Central Regional Office, 7035 W. Tidwell Road, Suite 105, Houston, Texas 77092.

The Federal Emergency Management Agency (FEMA) publishes a booklet entitled *Questions and Answers on the National Flood Insurance Program.* For further information, call the National Flood Insurance Program at 1-800-638-6620.

Before purchasing insurance, the buyer should know the policy's exclusions. If the purchaser discovers important gaps in coverage, the use of specific endorsements or other possible avenues of coverage should be explored with the insurance agent.

Conditions

The conditions of a policy suspend, rescind, modify, stipulate and qualify the insurer's obligation for various situations. The Texas homeowner's insurance policy has three sections entitled *Conditions.* The first deals strictly with conditions affecting the insurer's obligations for casualty losses, the second with liability claims, and the third with both casualty losses and liability claims. This report covers the first and third sections.

Conditions Affecting Casualty Losses

The following 14 items pertain to the insurer's obligations for casualty losses.

Insurable Interest and Limit of Liability

As indicated earlier, a person must have an insurable interest in property to purchase, and to receive reimbursement from, an insurance policy. Where more than one person have an insurable interest in the damaged property, the policy limits the recovery to no more than the amount of the insured's interest at the time of loss or the applicable limit of liability, whichever is less.

Reimbursement for a fire loss to buildings (Coverage A) has an unusual condition attached to it. Each time a fire loss occurs to an insured building, the amount of insurance is reduced by the amount of the loss. As repairs are made to that building, the amount of insurance is reinstated up to the limit of liability shown on the declaration page.

Residential Community Property Clause

The policy avoids determining the party or parties entitled to reimbursement when (1) the property is residential community property and (2) the spouses have been divorced or changed ownership. Basically, the policy remains in full force and effect as to both spouses unless the coverage is excluded by an endorsement (HO-142) or until the policy is canceled.

Insured's Duties after Loss

The insured must follow a prescribed procedure to receive reimbursement for an insured peril. The insured must:

- give the insurer or insurance agent prompt notice of the loss;
- notify the police in case of theft;
- protect the property from further damage;
- make reasonable and necessary repairs to protect the property;
- keep an accurate record of repair expenses;
- furnish a complete inventory of the damaged personal property showing the quantity, description and amount of loss, attaching to it all bills, receipts and related documents justifying the figures in the inventory;
- provide the insurer as often as reasonably required

  a. access to the damaged property;

b. pertinent records and documents (and allow insurer to make copies thereof);

c. personal examination, under oath, that is signed and sworn to;

- send to the insurer or agent, *within 91 days of loss*, a signed, sworn **Proof of Loss** stating, to the best of the insured's knowledge and belief

a. the time and cause of loss,

b. the interest of the insured and others in the property,

c. other insurance that may cover the loss and

d. the actual cash value of each item of damaged property and the amount of loss to it.

Note. Generally, a Proof of Loss form is available from the insurance company. The purchaser should ask the agent. If the insurance company does not request a Proof of Loss form within 60 days after being notified of a loss, none is required.

To assist the homeowner, an inventory of the items in the home should be made when the policy is purchased. Photographs or videos should be taken of each room, closet, drawer, garage, storage building and other locations where belongings are kept. Receipts from purchases for substantial items such as carpeting, furniture, electronic equipment and major appliances should be saved to document evidence of their value, style and model.

The inventory, photographs and receipts should be maintained in a safe, fireproof place in the home, or in a safety deposit box or other off-premise location for preservation in the event the home is destroyed by fire or storm.

In the event the insured makes a claim under the replacement cost coverage of the policy, several items must be added to the Proof of Loss statement. The Proof of Loss must state the replacement cost both of the described dwelling and any other building on which a loss is claimed, and the full cost of repair or replacement of the loss without deduction for depreciation.

Loss Settlement

The loss settlement procedure has two parts, one for personal property, the other for buildings. The limit of liability is the prime factor in settlements for personalty. Both the limit of liability and the level of the insured replacement value are prime determinants in settlements for buildings.

For the loss settlement of **personal property,** including wall-to-wall carpeting, cloth awnings and fences, the payment for covered losses will not exceed the smallest of the following:

- the actual cash value at the time of loss, taking into consideration the proper deduction for depreciation,
- the cost to repair or replace the damaged property with material of like kind and quality, less any proper deduction for depreciation or
- the specified limit of liability for Coverage B.

Note. If endorsement HO-101 has been added, the replacement cost for the personal property will govern based on the limitations of the endorsement.

For the loss settlement of **dwellings**, not including wall-to-wall carpeting, cloth awnings and fences, the payment for covered losses will be determined as follows:

- If, at the time of loss, the limit of liability for Coverage A is 80 percent or more of the full replacement cost of the dwelling, the insurer will pay up to the limit of liability for the damaged building structure(s) without deduction for depreciation.
- If, at the time of loss, the limit of liability for Coverage A is less than 80 percent of the full replacement cost of the dwelling, the insurer will pay only a portion of the replacement cost of the damaged building structure(s). The portion paid is calculated by dividing the limit of liability for Coverage A by 80 percent of the replacement cost of the dwelling times the actual replacement cost of the loss.
- If the actual cash value of the loss is greater than the replacement cost, the insurer will pay the actual cash value up to the limit of liability.

The phrase, *full replacement cost of the dwelling,* as used in the formulas, does not include the value of excavations, underground pipes and wiring, and foundations that are below the surface.

The insured must repair or replace the dwelling within 180 days after the loss unless a written request is made for a 180-day extension. When the repair or replacement is completed, the insurer will pay the additional amount claimed for the replacement cost coverage. However, the total payment will not exceed the smallest of the following:

- the limit of liability under the policy applicable to the damaged or destroyed building structure(s),
- the cost to repair or replace that part of the building structure(s) damaged, with material of like kind and quality for the same use and occupancy on the same premises or

- the amount actually and necessarily spent to repair or replace the damaged building structure(s).

Effective April 1, 1991, the State Board of Insurance mandated that **the insured must replace all insured property before replacement cost coverage will be paid.** If not replaced, only the actual cash value of the property at the time of loss is payable.

Thus, the insured is eligible for the actual cash (or depreciated) value of the dwelling immediately after the loss. If replaced within the designated 180 (or 360) days, then the difference between the replacement costs and the actual cash value of the dwelling may be claimed by the insured.

However, there are limitations. First, the replacement must be with like kind and quality of material. For example, if more expensive shingles are used as replacement, only the replacement costs of the original quality shingles may be recovered.

Second, expenditure for a necessary repair must be out-of-pocket. Time and effort expended by the insured repairing the dwelling is noncompensable. Also, unnecessary renovations and repairs cannot be claimed.

There are two instances when the homeowner need not worry about meeting the 80 percent level of replacement cost.

- The insurance company has added endorsement HO-102, "Agreed Amount on Dwellings," as discussed under "Endorsements" on page 6.
- The home is totally destroyed by fire. Section 6.13 of the Texas Insurance Code states that the insurance company must pay the full amount of the policy limits for the dwelling even though less than 80 percent of the full replacement cost is insured.

Examples of Coverage for Dwelling

A few examples help explain how the 80-percent rule operates in the three formulas.

Suppose the full replacement cost of a dwelling is $100,000. It is insured for $80,000 or 80 percent of its replacement cost. An insured peril causes $65,000 worth of damages. The insured would receive the full amount of the loss or $65,000. However, if the loss had been in excess of $80,000, the recovery would be limited to $80,000.

Assume the same dwelling is insured for 60 percent of its replacement cost. The formula for determining the insured's recovery becomes:

$$\text{(Replacement Cost of the Loss)} \times \frac{\text{Coverage A (Dwelling) Limit of Liability}}{\text{80\% of Replacement Cost of the Dwelling}}$$

If an insured peril causes $65,000 worth of damages, the insured would receive $48,750 or

$$\$65{,}000 \times \frac{\$60{,}000}{\$80{,}000}$$

In this case, the failure to maintain adequate insurance resulted in a $16,250 deficiency in coverage.

Negotiated Final Settlement

In the Proof of Loss form, the insured must submit, under oath, to the best of the insured's knowledge and belief, both the actual cash value and the amount of loss to each item of damaged property. If endorsement HO-101, "Replacement Cost for Personal Property," has been added, then the Proof of Loss must contain an estimated replacement value of the damaged property. Catalogs, contractors and retailers are good sources of current replacement value.

After the Proof of Loss is filed, the insurance company's adjuster views the damaged property. The adjuster estimates the same information contained in the Proof of Loss.

If the homeowner does not agree with the adjuster's estimate, the two parties will attempt to settle the difference. If a settlement is reached and put in writing, the insurance company will pay within 60 days. If no agreement can be reached, either party can demand, in writing, an *appraisal*.

Appraisal

Within 20 days after the written notification of nonagreement is received, each party selects a competent, independent appraiser and notifies the other of the appraiser's identity.

The two appraisers then choose a third party as an umpire. If the two appraisers cannot decide on an umpire within 15 days, either insurer or insured may request that a district court judge from the judicial district where the loss occurred make the choice.

The two appraisers then set the amount of the loss, stating separately the actual cash value and loss of each item. If requested, the appraisers also will set:

- the full replacement cost of the dwelling,
- the full replacement cost of any other building upon which a loss is claimed and

- the full cost of repair or replacement of loss to the dwelling or building, without deduction for depreciation.

If the appraisers fail to agree, their differences are submitted to the umpire. An itemized decision will be filed with the insurer. Each party pays its own appraiser and bears the expenses of the umpire equally.

The award is based on the figure determined by the appraisal process and is binding on both parties. The insurance company will pay the award within 60 days after the final appraisal is filed with the company.

Texas case law imposes a duty of good faith and fair dealing on insurance companies when settling claims. A company is subject to legal action for failing to settle valid claims promptly and fairly within the limits of the policy.

Policyholders who feel they have been treated unfairly, or who have questions about the claims process, may contact the State Board of Insurance at 1-800-252-3439. A claims specialist who handles homeowners' complaints may be reached at 512-463-6514.

For more complex problems that may require an investigation, a complaint form may be filed with the board. Complaint forms may be obtained by calling the State Board of Insurance at the toll-free number.

Loss to a Pair or Set

In case of loss to an item that is part of a pair or set, the measure of damages shall be a reasonable and fair portion of the total value of the pair or set. The importance of the item will be considered. The loss will not be considered a total loss of the pair or set.

Insurer's Options

The insurance company reserves the right to either pay for a loss to damaged property or repair or replace any part of it with property of like kind and quality. If the insurer elects to repair or replace instead of pay, the insurer must give notice within 30 days after receipt of the signed and sworn Proof of Loss.

Other Insurance

Other insurance is permitted on personal property but not on the dwelling. (No penalties are described, however, for having other insurance on the dwelling.) If there is other insurance for a covered loss, the insurer will pay only the proportion of the loss that the limit of liability bears to the total amount of all insurance covering the loss.

For example, the insured has two policies covering personal property. The limit of liability for Policy A is $30,000 and for Policy B, $50,000. Fire causes $25,000 damage to the property.

Policy A would cover $9,375 of the loss (less the deductible). This figure is derived by dividing the limit of liability ($30,000) by the total coverage of both policies ($80,000). The resulting fraction (0.375) is multiplied by the amount of the damage ($25,000).

The rule prohibits the policyholder from overinsuring. The insured receives no greater recovery from having two or more insurance policies than from having one. **In fact, if both policies have a deductible, the insured may receive less.**

Suit Against Insurer

Any legal action brought against the insurer must be filed within two years and one day after the cause of action accrues. A cause of action accrues when the insurance company wrongfully denies coverage. Normally, this occurs when the insured receives a denial-of-coverage notice. A prerequisite for bringing a lawsuit is compliance with the policy's provisions regarding recoveries.

Abandoned Property

The policy prohibits the insured from abandoning property to the insurer.

Vacancy of Dwelling

A dwelling is deemed vacant when the insured physically leaves and removes a substantial part of the personal property. Coverage A protection under the policy ceases 60 days after the dwelling becomes vacant.

Mortgagee Clause

The mortgagee clause addresses the lender's rights under the policy for the buildings. See "Parties Insured" on page 5.

No Benefit to Bailee

To understand the contractual condition entitled "Benefit to Bailee," the purchaser needs to understand the law of bailment. A *bailment* is the delivery of personal property to another (known as the bailee), in trust, for the execution of a particular purpose. When the specified purpose has been accomplished, the personal property must be redelivered to the owner (bailor) or to another specified individual. Bailments arise in a number of ways. For instance, letting a friend borrow a car, leaving a watch for repair at a jeweler, boarding a pet or even sending items through the mail may constitute bailment.

The bailee in possession of the personal property is charged with its care. The bailee may be liable to the bailor for the property's loss or destruction. The standard of care the bailee must exercise in protecting the property depends on whether the bailee is getting paid for the bailment, i.e., a *bailee for hire.*

The insurance policy provides that if a loss is caused by a person or organization holding, storing or moving property for a fee, no coverage under the policy shall benefit such bailees. For example, an insured takes winter clothes to the cleaners . A fire, caused by the cleaner's negligence, destroys both the building and the winter clothes. Two parties are liable for the loss. The insurance company is liable for the off-premises coverage for personal property. The cleaners (bailee for hire) also is liable for its negligence.

Because the policy provides that its coverage shall not benefit a bailee for hire, a payment by the insurance company to the insured shall not relieve the cleaner's obligation to repay the insurance company for the loss.

The insurer will not recognize any assignment or grant any coverage to bailees for hire.

Conditions Affecting Recovery

The following nine items pertain to the insurer's liability for either a casualty loss or a liability claim.

Policy Period

The policy applies only to losses that occur during the policy period described on the declaration page. As mentioned earlier ("Loss of Use of Dwelling," page 7), the actual payment(s) for the loss may extend beyond the policy period.

Concealment or Fraud

The policy is void if an insured intentionally conceals or misrepresents any material fact or circumstance, makes false statements or commits a fraud, either before or after a loss.

Liberalization Clause

If the State Board of Insurance adopts a revision to the basic homeowner's insurance form that broadens or extends the coverage under the policy without additional premiums, the adopted revisions apply immediately to this policy. The same applies to an adoption made by the board 45 days before the policy was issued.

Waiver or Change of Policy Provisions

Changes may be made and insured perils added by attaching a written endorsement to the policy that is properly executed by an authorized agent. However, no provisions may be waived unless so authorized by the terms of the policy. A request for an appraisal or examination does not waive any of the insurer's rights.

Cancellation

The **insured** may cancel the policy at any time by notifying the insurer of the effective date of cancellation. Thereafter, a refund of premiums, based on a short-rate procedure, will be sent to the insured when the policy is returned.

The **insurer** may cancel the policy for any one of three reasons:

1. nonpayment of premium,
2. an increase in hazard within the insured's control that would produce an increase in rate or
3. determination by the State Board of Insurance that continuation of the policy would violate the Texas Insurance Code.

To cancel, the insurer must give an advance written notice. A 14-day advance notice is required if the cancellation is for the nonpayment of premiums. To cancel the policy for any other reason, a 30-day notice is required.

The insured must demand a refund of premiums when the insurer cancels. A refund of premiums will not accompany the notice of cancellation.

Note. The policy references two methods of calculating refunds, the pro-rata procedure when the insurer cancels and the short-rate procedure when the insured cancels. No methodology is given.

The pro-rata procedure calculates the refund based on the effective date of cancellation over the length of the prepaid period. For example, suppose an insured pays a $500 premium for one year's coverage commencing on January 1. If the insurer cancels the policy effective June 30, the insured is entitled to a $250 refund.

The short-rate procedure penalizes the insured an additional month's premium. For example, assume the same facts except the insured, not the insurer, cancels the policy effective June 30. In this case, the insured is entitled to a $212.50 refund.

Nonrenewal

The renewal of a policy is not automatic. If the insurer chooses not to renew, written notice must be given both to the insured by mail or personal delivery and to the mortgagee noted on the declaration page. The notice must be given 30 days before the expiration date of the policy. The insured may require a renewal of the policy if an improperly timed notice is sent or delivered. However, only the insurer's proof of mailing the notice is required.

Assignment

As mentioned under the bailment conditions, an assignment of the policy is not binding on the insured unless the insured consents in writing.

Subrogation

If the insurer is liable for a property loss, the company may require the insured to assign (or subrogate) all rights of recovery against the party responsible for causing the loss. The insured shall do nothing to prejudice the rights of the company to recover from the third party. The assignment shall be for the payments made by the company.

The insured may waive the right of recovery from a third party for a casualty loss, but the waiver must be given **before** the loss occurs.

If the insurance company seeks an assignment (subrogation) of rights against a third party, the insured must sign and deliver all related papers and cooperate with the insurer.

Named Insured's Death

The policy directs whom the policy covers if the named insured dies. The directions closely parallel the policy's definition of *an insured.*

If the named insured dies, the policy insures

- the named insured's spouse, if a resident of the same household *at the time of death*,
- the legal representative of the deceased, i.e., executor or administrator and
- any person who is an insured at the time of death but only while a resident of the premises.

Conclusion

Homeowners typically have some type of property insurance for their dwelling and personal effects. Some purchase the insurance because they cannot sustain a financial loss. Others purchase it because it is required by the mortgage lender.

Regardless of the reason, homeowners may be uncertain about the policy's coverage, the meaning of its conditions and exclusions. Typically, the purchaser relies on the advice of the issuing insurance broker or the procuring agent, both to establish insurance needs and to acquire the necessary protection. The arrangement has obvious drawbacks when the needs of the purchaser are not communicated clearly and accurately to the issuing broker or when the needs of the purchaser change during the policy period. This report is intended to help purchasers understand the Texas Homeowners Policy.

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Appendix A

Definition of Terms Applicable Both to Casualty and Liability Coverage

Business—a trade, profession or occupation.

Insured—the person or persons listed as the named insured on the declaration page. The term includes the spouse and relatives of the named insured who reside in the same household. It also includes any person under the age of 21 in the care of the named insured, a spouse or a relative in the same household. (Sometimes the policy refers to the insured as *you*.) The definition is subject to change if endorsement HO-301 is added to the policy.

Insured location—

a. the residence premises (*defined later*)

b. the part of other premises, other structures and grounds that the insured uses as a residence and

   1. which is shown on the declaration page or

   2. which the insured acquires during the policy period to use as a residence

c. any premises the insured uses in connection with premises described in (a) or (b) above

d. any part of the premises

   1. not owned by an insured and

   2. where an insured is temporarily residing

e. vacant land, other than farm land, owned by or rented to an insured

f. land owned by or rented to an insured on which a one- or two-family dwelling is being built as a residence for an insured

g. individual or family cemetery plots or burial vaults of an insured

h. any part of a premises occasionally rented to an insured for other than business use.

The definition is subject to change if endorsement HO-305 is added to the policy.

Occurrence—an accident, including exposure to conditions, which results in bodily injury or property damage during the policy period.

Property damage—injury to, destruction of or loss of use of property.

Residence employee—an employee of an insured who performs duties related to the ownership, maintenance or use of the residence premises, including maintenance or use of a motor vehicle. This includes employees who perform similar duties elsewhere for an insured. This does not include employees while performing duties related to the business of an insured.

Residence premises—the one- or two-family dwelling shown on the declaration page, including other structures, and grounds where an insured resides or intends to reside within 60 days after the commencement of the policy.

You, Your—the named insured as defined earlier. The definition is subject to change if endorsement HO-301 is added to the policy.

We, Us, Our—the insurer or company providing the coverage.

Appendix B

Homeowner Endorsements for Casualty Insurance Policy

New Number	Name	Former Number
HO-101	Replacement Cost for Personal Property	(HO-365)
HO-102	Agreed Amount on Dwellings	(HO-70)
HO-105	Residence Glass Coverage	(HO-349)
HO-110	Increased Limit on Jewelry, Watches and Furs	(HO-339)
HO-111	Increased Limit on Business Personal Property	(HO-391)
HO-112	Increased Limit on Money/Bankcards	(HO-315)
HO-113	Increased Limit on Bullion/Valuable Papers	(HO-315)
HO-120	Television and Radio Antennas	(HO-309)
HO-121	Windstorm Coverage for Greenhouses	(HO-311)
HO-122	Windstorm Coverage for Cloth Awnings	(HO-312)
HO-125	Physicians, Surgeons and Dentists Outside Coverage	(HO-313)
HO-126	Personal Computer Coverage	(HO-390)
HO-130	$250 Theft Deductible	(HO-364)
HO-140	Windstorm, Hurricane and Hail Exclusion	(HO-224)
HO-142	Exclusion of Residential Community Property Clause	(HO-100A)
HO-160	Scheduled Personal Property Coverage	(HO-355)
HO-170	Additional Extended Coverage	(HO-366)
HO-301	Additional Insured	(HO-301)
HO-305	Amended Definition of Residence Premises	(HO-363)
HO-310	Townhouse Loss Assessment Coverage	(HO-370)

Appendix C

Perils Insured Against for Personal Property Unless Excluded by Appendix D

1. Fire and lightning.
2. Sudden and accidental damage from smoke.
3. Windstorm, hurricane and hail.
4. Explosion.
5. Aircraft and vehicles.
6. Vandalism and malicious mischief.
7. Riot and civil commotion.
8. Collapse of all or any part of building.
9. Accidental discharge, leakage or overflow of water or steam from within a plumbing, heating or air-conditioning system or household appliance.

Note. Certain limitations are placed on coverage. A loss from peril number 9 includes the cost of tearing out and replacing any part of the building necessary to repair or replace the system or appliance. The coverage does not include a loss to the system or appliance from which the water or steam escaped.

Likewise, the first eight exclusions mentioned in Appendix D do not apply to a loss caused by this peril.

10. Falling objects. However, this peril does not include a loss to property contained in a building unless the roof or outside wall of the building is first damaged by the falling object.
11. Freezing of household appliances.
12. Theft, including attempted theft and loss of property from a known place when it is likely that the property was stolen.

Appendix D
Exclusions from Policy Coverage

The following exclusions apply to losses to property both in Coverage A and B. However, the exclusions do not apply to an ensuing loss caused by fire, smoke or explosion.

1. Loss to electrical devices or wiring caused by electricity, other than lightning.
2. Loss caused by smog or by smoke from industrial or agricultural operations.
3. Loss caused by windstorm, hurricane and hail to:
   a. cloth awnings, greenhouses and their contents; buildings or structures located wholly or partially over water and their contents;
   b. radio and television towers, outside satellite dishes, masts and antennas, including lead-in wiring, windchargers and windmills;
   c. personal property contained in a building unless direct force of wind or hail makes an opening in a roof or wall and rain, snow, sand or dust enters through the opening and causes the damage.
4. Loss to the following property by theft, including attempted theft, and loss of property from a known place when it is likely that the property has been stolen:
   a. personal property while away from the residence premises at any other residence owned by, rented to or occupied by an insured, except while an insured is temporarily living there;
   b. building materials and supplies not on the residence premises.
5. Loss to machinery, appliances and mechanical devices caused by mechanical breakdown.

*6. Loss caused by
   a. wear and tear, deterioration or any quality in property that causes it to damage or destroy itself;
   b. rust, rot, mold or other fungi;
   c. dampness of atmosphere, extremes of temperature;
   d. contamination;
   e. rats, mice, termites, moths or other insects (fire ants).

*7. Loss caused by animals or birds owned or kept by an insured or occupant of the residence premises.

*8. Loss to Coverage A property (the dwelling) caused by settling, cracking, bulging, shrinkage or expansion of foundations, walls, floors, ceilings, roof structures, walks, drives, curbs, fences, retaining walls or swimming pools.

9. Loss caused by or resulting from flood, surface water, waves, tidal water or tidal waves, overflow of streams or other bodies of water or spray from any of these perils, whether or not they are driven by wind. However, an ensuing loss by theft or attempted theft or any act or attempted act of stealing is covered.
10. Loss caused by or resulting from freezing while the building is unoccupied unless the insured has used reasonable care to:
    a. maintain heat in the building or
    b. shut off the water supply and drain plumbing, heating and air conditioning systems of water.
11. Loss caused by earthquake, landslide or earth movement.
12. Loss caused by the destruction of property by order of governmental authority. However, a loss caused by acts of destruction ordered by governmental authority at the time of a fire to prevent its spread is covered if the fire would have been covered under this policy.
13. Loss caused by or resulting from the enforcement or any ordinance or law regulating the construction, repair or demolition of a building or structure.
14. Loss resulting directly or indirectly from war. This includes undeclared war, civil war, insurrection, rebellion, revolution, warlike act by military personnel, destruction or seizure or use for a military purpose, and any consequence of these. Discharge of a nuclear weapon will be deemed a warlike act even if accidental.

15. Loss resulting directly or indirectly from nuclear reaction, radiation or radioactive contamination, all whether controlled or uncontrolled or however caused. The policy does cover direct loss by fire resulting from nuclear reaction, radiation or radioactive contamination.

* Exclusions (6), (7) and (8) do not apply to an ensuing loss caused by a total or partial collapse of a building, by water damage or by breakage of glass that is part of the building provided the initial collapse, water damage or glass breakage was covered by the policy.

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