

## LESSON 2.7 HOMEOWNERS POLICY SECTION I: CONDITIONS

You have been introduced to Exclusions that apply to coverages in Section 1: Property Coverage. Exclusions are policy provisions that limit or restrict coverage and are written into a policy because insurance companies cannot reasonably nor affordably cover every loss imaginable.

What are some of the Section I Exclusions in the HO3 policy?

If you answered that the HO3 policy Section I Exclusions include certain conditions related to Ordinance or Law, Earth Movement, Water Damage, Power Failure, War, Nuclear Hazard, Intentional Loss, and Governmental Action, you are right. Look at Section I Exclusions to review.

The final part of Section I of the Homeowners Policy explains Conditions. This will be our last stop in our journey through Section I before we continue to the next part of the policy: Section II Liability Coverage.

Find Section I Conditions in your copy of the HO3 policy. Conditions are obligations required of **both** the insured and the insurance company to carry out the policy's provisions. Do you recall the Agreement we examined at the beginning of the policy? An insurer promises to provide insurance described in the policy in return for paid premium and *the insured's compliance with the contractual obligations and conditions*.

In this lesson, we will identify key Conditions in Section I of a Homeowners Policy. There are 19 conditions that both the insured and the insurance company must abide by. We will touch on each one of these and then discuss how losses will be paid by the insurance company. As we examine these Conditions, take special note of Key Conditions. These are **essential** Conditions that you will want your clients to be aware of.

**Condition A, Insurable Interest and Limit of Liability** is a key condition that limits the amount the insurance company is obligated to pay to the maximum limits provided in the policy. This condition also states that even if there is more than one insurable interest — say, the homeowner and the mortgage company for example; the most the insurance company is obligated to pay is the applicable limit of coverage in place at the time of loss.

**Condition B, Deductible** is another key condition that enforces the application of the selected policy deductible or deductibles if more than one exists. Remember deductibles are selected by the insured and are displayed in the policy Declarations Page. A deductible is the portion of the cost of a claim for which the insured is responsible. It is common to see homeowners' policies with a Wind and Hail deductible higher than the deductible for all other types of losses. The deductible condition states that the policy deductible will apply to the claims paid, and if more than one deductible applies, the highest deductible will apply. If the amount of the covered loss is less than the stated deductible (the part that the

insured is responsible for paying) the insured will not receive payment on the claim.

Here's an example of how this works. Scott noticed his carpet flooring was very wet in the coat closet and hallway next to the water heater cupboard. He discovered that the water tank was cracked and filed a claim with his insurance company. Scott's policy has a \$2,500-dollar deductible, but the cost of repairs was \$2,200 dollars. So, even though the loss is a covered loss, the insurance carrier will not pay for the damages because the total cost to repair the damage is less than Scott's \$2,500-dollar policy deductible.

**Condition C, Duties After a Loss** is a key condition that identifies eight duties an "insured" must perform after a loss. Otherwise, the insurance carrier has no duty to provide coverage. These eight duties of the insured are:

- The insured must give prompt notice of loss.
- The insured must notify police if the loss is caused by theft.
- The insured must notify credit card companies if the loss is related to credit card forgery.
- The insureds must reasonably protect property from further damage, like boarding up a broken window. They should also keep a record of repair expenses to submit to the insurance company.
- The insured must cooperate with the carrier during the investigation of the claim.
- The insured must provide a list of damaged personal property that includes quantity, description, and value. Receipts may be necessary.
- The insured must show damaged property to the insurance company, provide records requested, and submit to and sign an examination by the insurance company while not in the presence of any other "insured."
- And finally, the insured must send a sworn proof of loss which must include, to the best of their knowledge, information such as: time of loss, cause of loss, if another insurance company could be involved, estimates of damage, inventory of damages, receipts for additional living expenses or loss of rent, or evidence that supports claims under Additional Coverages, for credit card forgery.

**Condition D, Loss Settlement** is a Key Condition that explains the application of Actual Cash Value and Replacement Cost and how personal property and buildings will be valued to determine the amount a claim will pay.

Remember that Replacement Cost (or RC) is the cost to replace damaged property with like kind and quality at today's value **and** Actual Cash Value (or ACV) decreases value of property appropriate to the age of the property or states a reduction in value for normal

wear and tear of the property just prior to the loss. Part 1 of Loss Settlement states that the following types of property will be settled with Actual Cash Value:

- Personal Property
- Awnings, carpeting, appliances, outdoor antennas and outdoor equipment
- And Structures that are **not buildings** (such as a pool)

Endorsements available to change Actual Cash Value to Replacement Cost include the **Personal Property Replacement Cost Loss Settlement endorsement** which improves coverage for personal property and the **Replacement Cost Loss Settlement for Certain Non-Building Structures on the Residence Premises endorsement** that improves coverage for other structures which are not buildings.

Part 2 of the Loss Settlement condition states that **buildings** under Coverage A (Dwelling) and Coverage B (Other Structures) will be valued at Replacement Cost without any deduction for depreciation in value. This is if the amount of insurance carried on the damaged building is 80% or more of the full Replacement Cost just prior to the loss. Replacement cost will not be paid, however, until repair or replacement is complete unless the loss is **both** less than 5% of the limit of insurance on the building **and** less than \$2,500 dollars. The most the policy will pay is the **LESSER** of the

- Limit of Liability in the Declarations Page,
- Replacement Cost of the damage, or
- Actual amount spent to repair or replace damage.

Endorsements are available to provide additional coverage above the policy limit as long as the insured maintains 100% Replacement Cost insurance on the Dwelling.

Here's an example. Dominique is insuring her home with a limit of \$150,000 dollars. A covered loss occurs and causes damage that will cost \$7,000 dollars to repair with identical materials. The Actual Cash Value of the damaged property is \$6,000 dollars. The replacement cost of the dwelling was determined to be \$140,000 dollars. Because Dominique is carrying a limit of liability greater than 80% of the determined replacement cost, disregarding deductibles, the loss will pay the \$7,000-dollar cost to replace the damage with identical materials.

If the coverage limit carried on the damaged building is less than 80% of the full replacement cost, the claim payment will be reduced. The applicable payment will not exceed the limit of liability and will be the **GREATER** of the following:

- Actual Cash value of the part of the damaged building, or
- The cost to repair or replace that part of the building that was damaged, which the

total amount of insurance in this policy bears to 80% of the replacement cost of the building.

The amount of the claim payment will be reduced, using the following formula:

$$\frac{\text{Limit Carried on Policy}}{\text{Replacement Cost} \times 80\%} \times \text{Loss}$$

Let's try this equation out. Sarah purchased a home and with her agent selected a dwelling coverage limit of \$60,000 dollars. A windstorm blew down a tree which landed on the home causing serious damage to it. It was determined that the replacement cost of the dwelling is \$100,000 dollars. The total cost of damages to repair the dwelling with identical materials is \$10,000 dollars. The Actual Cash Value of the damaged property is \$8,000 dollars. Because Sarah carried a Coverage A limit of liability less than 80% of the replacement cost, the \$10,000-dollar loss will be reduced; however, because the ACV cost of the damaged property is greater than the formula reduction, the claim will pay the greater ACV value of \$8,000 dollars.

**Condition E, Loss to Pair or Set** states that when a covered loss occurs to a pair or set, the company may replace or repair any part to restore the set or the company may pay the difference between actual cash value before and after the loss.

**Condition F, Appraisal** sets forth guidelines for obtaining appraisals to damaged property if the company and insured disagree on the values of the damaged property.

**Condition G, Other Insurance and Service Agreement** describes the extent of its obligations should an "insured" have other insurance or a service plan, such as a home warranty.

**Condition H, Suit Against Us**, states that a lawsuit can only be brought against the insurance company provided the "insured" has complied with all policy terms.

**Condition I, Our Option** states that the insurance company has the right to repair or replace damaged property with like kind or quality.

**Condition J, Loss Payment** states when payments for loss will be paid. The conditions for this are that the loss is payable within 60 days after proof of loss is received, an agreement with the "insured" is reached, there is an entry for final judgment, or there is a filing of appraisal award.

**Condition K, Abandonment of Property** states that the insurance company is not obligated to receive abandoned property.

**Condition L, Mortgage Clause** allows for losses payable under Coverage A (Dwelling) and

Coverage B (Other Structures) to be paid to the mortgagee and “insured,” and also states that if a claim is denied to an “insured,” it will not be denied to the Mortgagee.

**Condition M, No Benefit to Bailee** states that coverage will not benefit a person or organization holding, storing, or moving property for a fee. This is to help ensure that if an insured hires a company, like a moving company, the company will be liable for damages to property in the move rather than the insured’s homeowners policy.

**Condition N, Nuclear Hazard Clause** further clarifies what a Nuclear Hazard is and reaffirms that losses caused by Nuclear Hazard will not be covered.

**Condition O, Recovered Property** coverage states that if property has been paid for by a covered loss under the policy, and the property is recovered by either the “insured” or the insurance company, that party will notify the other. Loss payment will be adjusted if property is recovered and the insured requests to keep the property.

**Condition P, Volcanic Eruption Period** adds that if one or more volcanic eruptions occurs within a 72-hour period, those events will be considered one eruption.

**Condition Q, Policy Period** is a key condition. This condition defines that only losses which occur during the active policy term will be considered.

**Condition R, Concealment of Fraud** informs the insured that no loss will be paid if it is found that the insured has intentionally concealed or misrepresented information, has engaged in fraudulent conduct, or has made false statements before or after the loss has occurred.

**And Condition S, Loss Payable Clause** is the final condition in Section I Conditions. This condition states that if a loss payee is listed on any property, a riding lawn mower for example, then the loss payee will be notified of cancellation or non-renewal notices.

What a fun journey we have had through the alphabet A through S of Section I Conditions! Remember that the conditions are important provisions in the policy that both the insured and the insurance company must adhere to. Conditions spell out what to expect and what duties must be performed.

Complete the assigned activities to help you understand how obligations set by the carrier, referred to as Conditions, affect coverage.