Property Insurance Basics

Having insurance is a way for people to be protected against some types of financial loss following a catastrophic event. For property owners, some insurance types may be required, while others may be advantageous. Learning some basic information about insurance can help property owners make informed decisions about the amount and types of protection they may need.

WHAT IS INSURANCE?

Insurance companies, also called insurers or underwriters, can provide policyholders financial protection for certain events, often called covered perils. You are a policyholder if you or your business have purchased financial protection from insurance companies. The policy is a contract that explains the conditions and circumstances under which the insurer will compensate (pay) the policyholder after a loss. Once insurance is purchased, the policyholder will have some amount of coverage from perils outlined in the policy. In this way, insurance policies help reduce how much a policyholder must pay out of pocket when a covered peril damages the covered property. There are multiple types of insurance covering a variety of needs that a property owner can purchase.

WHAT ARE MY COSTS?

When you buy an insurance policy of any kind, you, as a policyholder, must make a payment to the insurance company for coverage. This payment is called a premium. In exchange for paying your premium, the insurance company agrees to cover you for certain perils by paying up to a certain amount—described in the policy—to cover losses.

The premium payment is considered a small but predictable loss to help guard against a large and uncertain loss due to a covered peril in the future.

The amount you pay for your premium is based on a number of factors including, but not limited to, the total coverage you are requesting (e.g., the value of your belongings), building construction year and materials, size/occupancy of the structure, types of perils covered, the likelihood or risk of a loss, the deductible level, and the regulations of the state you live in.¹

While the risk assessment and premium rates are not under your control, you may be able to choose how much coverage you want. For example, when purchasing a policy to cover the personal contents of a home, you as a renter or homeowner might choose to have enough coverage to replace all property inside your residence, or you might opt for a less expensive policy that would only cover the loss of electronics or furniture.

Another way you could reduce premium rates is to choose policies that provide actual cash value (ACV) payments for losses instead of replacement cost value (RCV) coverage.¹ While the upfront cost for ACV coverage is less than RCV, ACV coverage...
Flooding is a concern for homeowners as flood events can cause considerable damage. However, homeowners should be aware that flood damage is not covered by most homeowners insurance policies. A separate type of insurance—known as flood insurance—must be purchased to cover flood-related damage. (LSU AgCenter)

will pay you less following a loss. This is because ACV pays the depreciated cost to replace items while RCV pays the full amount needed to replace items. For example, it may cost you $7,000 to replace a collection of electronic items following a loss. If you have RCV coverage, you would be paid $7,000 (minus the deductible) by your insurance company to replace the damaged or destroyed items. However, if you opted for ACV coverage, the payout from your insurance company may be significantly less. Depending on their age, condition, or market value, that same collection of electronic items may be valued at only $500 under ACV coverage.

You can expect your insurer to pay some money, but your insurer will often set further requirements on you prior to paying out a claim. One such requirement is called a deductible. A deductible is the mandatory out-of-pocket expense that you must cover for the damage or loss before the insurer will begin to pay out on the policy. For example, if you had a $15,000 covered loss with a $2,000 deductible, the insurance provider would compensate you with $13,000 ($15,000 - $2,000 = $13,000).

Policies with large deductibles typically have lower premiums. This is because the insurance company has less financial risk; meaning policyholders are responsible for more out-of-pocket following a loss. The reverse is also true; policies with low deductibles come with higher premiums. Additionally, the same policy may have different deductible levels for different types of perils (e.g., storm versus fire). The question for you is, can you afford to pay a little more now to avoid a larger expense in the event of a loss or are you better off saving money on the front end knowing that you may have greater out-of-pocket expenses if a covered peril occurs?

Deductibles are not the only out-of-pocket expenses that you may have following a loss. For example, you may purchase an insurance policy that covers a maximum of $30,000 in damages after a burst pipe. However, if the actual damage or cost of rebuilding and repairs is higher, then you are responsible for paying the cost difference. The maximum amount that an insurance policy will pay out for a covered peril is called a coverage limit. For many homeowners, their mortgage company will require...
full coverage, or set the minimum-maximum coverage for a structure. The coverage will be based on the cost of rebuilding the structure. Some perils that could damage a home or property might not be included under the policy. This is called an exclusion (see sidebar).

### Key Differences Between Expenses

- **Premium**: Payment to an insurer to cover the cost of the policy.
- **Deductible**: Out-of-pocket costs toward loss/repairs that the policyholder is expected to pay. This amount is deducted from the total insurance payout.
- **Coverage limit**: Maximum amount that an insurer will pay to a policyholder for a covered peril.
- **Coverage exclusion**: Losses that a policy does not cover.

### What Types of Insurance Exist for Homeowners?

Basic homeowners insurance helps policy-holding homeowners be partially compensated for damages to the home itself, other structures on the property, as well as people and belongings in the home. Coverage can vary based on the specific insurance policy, but perils covered in a basic homeowners insurance policy might include fire, lightning strikes, theft, hail, and vandalism. Each policy is different, so it is important to understand which perils are covered and which are not. Table 1 highlights the different types of homeowners insurance policies that are available in addition to basic coverage. These additional types of insurance are available at an additional charge and are sometimes referred to as riders. Insurers may require a risk assessment of a property before agreeing to sell you a policy. The insurer may decline to cover your property for a peril if it is found to be at high risk of damage.

### What is Meant by an Exclusion?

Often policies limit the level of coverage for some perils and explicitly deny or exclude others. For example, a policy that covers damage to your home due to hail might not cover damage caused by wind during the same storm. Or your policy may cover flooding damage in your residence following a burst pipe but exclude the cost of the plumbing repairs. Further, mold resulting from a leaking roof or burst pipes may not be covered through standard homeowner policies. If it is covered, it is frequently capped at $10,000. It is important for you to read your policies carefully for potential exclusions and consult with an insurance agent about additional coverage options (Table 1).

### Table 1

Examples of add-ons—called endorsements or riders—to a renters or homeowners policy. These are separate types of property insurance coverage available in the United States. Riders or separate policies may be purchased in addition to a basic policy to cover these different types of perils. Please check out the available hyperlinks (in blue) in the table to learn more from federal and state agencies. For complete URLs to these resources, please see the reference section.

(Images: FEMA; Integration and Application Network/Jane Hawkey; USDA/Scott Bauer)
Trees falling during a storm can lead to roof, vehicle, or fence damage, like pictured here. Each of these types of damage have different kinds and levels of coverage, including potential exclusions or coverage limits. Some homeowners policies may even cover the loss of the tree itself, up to a point, if it is on a covered property. It’s important to verify your coverage prior to a storm and to consult with your insurance agent immediately after a storm should your property suffer damage during a covered peril. (M. Partyka)

While homeowners insurance is a requirement to get a mortgage in most cases, homeowners may consider purchasing additional, separate policies to cover damage from other perils, such as floods and earthquakes. Insurance coverage is not standardized and can vary by state. For this reason, it is best to check with a local insurance agent about coverage in your area.

Different coverages, or parts of basic homeowners insurance, may have different coverage limits. Each part covers specific components of the home during covered perils:

- **Dwelling**: Provides financial support for repairs or a rebuild when damage occurs to the physical structure of the home (e.g., roof and walls). It does not cover contents or damage to the land that the house sits on (e.g., garden, sinkholes, erosion), or other structures unattached to the house (e.g., barn, shed).

- **Other structures**: Covers damage to fences, sheds, or other detached structures on the homeowner’s property. This coverage may be limited to 10 percent of the dwelling coverage limit.

- **Personal contents**: Covers the loss of belongings inside covered properties. There are often specific exclusions or limits associated with what property is covered and not covered.

- **Loss of use, also called additional living expenses (ALE)**: Part of a homeowners policy that provides financial support if the dwelling becomes uninhabitable following a covered peril. Coverage may include hotel stays, rent for
alternative housing, meals, laundry services, and even rental income protection if a homeowner is unable to rent their insured rental property following a loss. Once the payouts reach the limit of the policy, the insurer will not pay additional living expenses.

- **Personal liability**: May cover certain costs associated with accidents that the homeowner is found liable for, such as a guest falling downstairs in the covered home. Examples of covered costs may include medical, legal, and lost wages for the injured person.
- **Medical payments**: Similar to liability protection in that it helps to cover medical costs for accidents involving guests in the home. Unlike liability protection, guest medical coverage will provide coverage even if the homeowner is not at fault for the accident.

**WHEN DO I PURCHASE PROPERTY INSURANCE?**

Property insurance, such as homeowners or renters insurance, is typically purchased for a full year and renewed annually. In certain circumstances, you may not be able to buy a new insurance policy or make changes to your existing policy for a period of time. For example, when a tropical storm or hurricane is in the Gulf of Mexico, many insurance providers will not write new policies for properties along the Gulf Coast until after the storm passes.

**WANT TO LEARN MORE?**

Contact a local insurance provider. You may also want to speak with multiple providers and/or insurance brokers that can help you compare and contrast different types of policies, coverages, and costs. Policies may have waiting periods and may take weeks to go into effect. You should allow plenty of time before your policy is needed.

A number of informative videos about different types of insurance can be found through the Insurance Information Institute, an organization focused on sharing fact-based information with consumers. [http://www.iii.org/resource-center/video-library](http://www.iii.org/resource-center/video-library)

Additional resources about the insurance industry can be found at the National Association of Insurance Commissioners. [https://content.naic.org/resource-center](https://content.naic.org/resource-center)

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*Boat piers and docks can be damaged or destroyed during storms and may not be covered by your property insurance. If the pier/dock is attached to the property it may be covered under the “Other structures” part of your policy. Contact your insurance agent about exclusions or the need for additional endorsements prior to storm season for these and other structures both attached and detached from your property. (MASGC)*
Disclaimer
The information provided in this publication is meant to provide general guidance but is not absolute. Policies, insurance, and mortgage requirements vary. Please refer to the specifics of your policy and consult with your insurance provider to understand the types of coverage, limitations, and other factors related to your specific policy.

GLOSSARY

Claim — A policyholder’s request to their insurance company for payment for a covered peril.

Coverage — Amount or type of possible risk or loss that a policy will insure against.

Coverage limit — The maximum level of financial risk that an insurance policy will pay for a covered event.

Deductible — The mandatory out-of-pocket expense that a policyholder must cover for the damage or loss before the insurer will begin to pay out on the policy.

Depreciated cost — Diminished value of an item over time.

Exclusion — Peril that an insurance policy will not provide financial compensation for.

Insurance broker — A licensed, third-party person who sells insurance to a consumer.

Liability — Legal or financial obligation or responsibility.

Mortgage — A loan from a bank or other financial company used to purchase or maintain a property.

Peril — Event that may damage a policyholder’s belongings and/or home.

Riders — Additional types of insurance (beyond basic coverage) that are available at an additional charge.

REFERENCES

ACKNOWLEDGMENT
Special thanks to the external reviewers who contributed to the betterment of this publication.

SUGGESTED CITATION:

This publication was prepared by Louisiana Sea Grant College Program, the Mississippi-Alabama Sea Grant Consortium, and Florida Sea Grant using federal funds under award NA18OAR4170438 from the National Sea Grant Office, NOAA, U.S. Department of Commerce. The statements, findings, conclusions, and recommendations do not necessarily reflect the views of these organizations.

MASGP-23-015 May 2023