

## My Florida Home Book 1.6: Additional Financial Aspects of Homeownership<sup>1</sup>

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### Carry Adequate Homeowner's Insurance

Homeowner's insurance is a wise way to protect yourself and your investment. Homeowner's insurance protects against financial loss in the event of destruction of or damage to your home and personal property. It will help pay to repair or rebuild your home and replace personal property lost to theft, fire, or other disasters such as storms.

Although Florida law does not require homeowner's insurance, your lending institution will require you to insure your home as long as they hold the mortgage. There may also be special requirements for insurance, such as those from developments and subdivisions, even if you don't carry a mortgage. It is your responsibility to shop around, compare, and select the best policy for you.

### Coverage Areas

Generally, you'll need insurance that provides three areas of coverage:

- Property
- Personal liability
- Medical payments

#### Property

This covers:

- Structure (house)
- Other structures (shed, fences, etc.)
- Personal property (possessions, contents of home)
- Loss of use (living expenses if home is unlivable due to damage)

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Be aware that you may need additional coverage for some personal property such as antiques, firearms, collections, etc. Protection for these items may require a special endorsement, or addition, to your insurance policy in order to be covered.

### Personal Liability

This protects you against a claim or lawsuit resulting from bodily injury or property damage to others while on your property. For example, if your dog bites a visitor or a neighbor slips and falls in your house.

### Medical Payments

These pay medical expenses for persons *other* than residents who are accidentally injured on your property. This coverage does *not* apply to anyone living in the house.

### Coverage Types

There are two types of insurance coverage:

- Actual cash value
- Replacement cost value

### Actual Cash Value

Actual cash value is the amount needed to repair or replace damage to your home after depreciation.

### Replacement Cost Value

Replacement cost is the amount needed to replace or repair your damaged property with materials of similar kind and quality, without deducting for depreciation. Your insurance agent may offer you replacement cost coverage for your home. If you choose not to have this coverage, you will be required to sign a statement on the application form stating that you do not want it.

Be sure you carry adequate insurance in case of damage. When you purchase homeowner's insurance, you need to buy enough to protect the structure and your personal possessions in the event of a loss. A general guideline is to cover your home and contents for at least 80% of the replacement value, excluding land. This means that you would be responsible for

damages equal to the deductible if you have to file a claim and that claim gets approved.

To make a determination of how much insurance you should purchase, multiply the number of usable square feet by the present cost of construction per square foot in the area OR hire a professional appraiser to estimate the cost of rebuilding. Always remember to keep your coverage up-to-date. Many policies offer an inflation guard endorsement that gradually increases the coverage limits annually to keep current with prices and inflation. If your policy lacks this endorsement, you will need to update your coverage periodically with your insurance agent or company.

### Flood Insurance

Most homeowner's insurance policies exclude damage caused by floods (rising water). Additional coverage for flood protection may be required if you are buying in a flood zone. If you are not buying in a flood zone, this coverage is optional. Based upon where your home is located, you may qualify to purchase flood insurance through the National Flood Insurance Program. Flood insurance coverage requires a 30-day waiting period before the policy becomes effective, unless purchased at the same time as your home. For more information regarding flood insurance, contact the National Flood Insurance Program at 1-888-FLOOD29 (1-888-356-6329).

### Apply for Homestead Exemption

Keep up with current tax exemptions that are available to you. Currently, Florida law allows at least \$25,000 in residential property value to be tax exempt. For example, if your home assesses at \$125,000 and you have filed for homestead exemption, your yearly residential property taxes are then on the remaining \$100,000 assessed value.

It is your responsibility to file for homestead exemption. If you fail to file, you will have to pay property taxes on the full-assessed value of your home. Shortly after you close on your home, you should go to the county tax assessor's office to file the necessary papers. You need only file one time once you own the particular property. It must be your primary residence and you may file for homestead

exemption for only one property at a time. You must take your title for the house, a deed, or contract for the deed, and be a permanent resident living in the house on January 1 of the year in which you apply.

## **Set Up an Escrow Account**

An escrow account is a special fund established by your lender that holds reserve funds in order to pay your property taxes and insurance on your behalf as they become due on your home during the year. Mortgages insured by the Federal Housing Authority or VA require escrow accounts. Most other mortgages also require an escrow account, though some may allow you to negotiate for the right to pay your own taxes and insurance. When an escrow account is required, be aware that any changes in property taxes or insurance will cause a change in your monthly mortgage payment.

One-twelfth of the tax and insurance premiums for the year is added to your monthly mortgage payment and held in the escrow account so that enough money is usually available when each is due. This protects both the mortgage lender and the investment on your home. When you establish an escrow account, the Real Estate Settlement Procedure Act (RESPA) limits the amount of the extra amount to ensure that the lender has enough money to make the payments when due ("cushion") to a maximum of two months of escrow payments. RESPA also protects your right to receive an initial escrow account statement within 45 days of your closing.

Buying an older house to remodel can have a number of pitfalls. The biggest one is overspending for the neighborhood or location. The value of adding on and major remodeling can be uncertain. Increasing the value of a house more than 15% over the top value in the neighborhood is seldom a good financial investment. If you buy a house in a \$50,000 house neighborhood and then add a \$24,000 addition, you are highly unlikely to sell your house to a family looking for a \$75,000 house. They will instead look in a \$75,000 house neighborhood. Another guideline to follow is that the cost of any improvement should be less than 60% of the cost of building a new home of equal size and quality.

Except for maintenance and basic improvements to keep the house in good condition, improvements and remodeling should be only for your own family's comfort and satisfaction. The financial return will usually yield no more than 75% of your investment and is rarely that high. Remodeling a home can also be a nightmare if the owner has limited knowledge and skills in remodeling techniques and practices and/or working with contractors.

## **Other Financial Aspects**

### **Maximize Tax Deduction**

Mortgage interest and property taxes may be fully deductible on income tax, although you must use a long form and itemize deductions. Points paid on a mortgage may count as a deduction on income tax in the year in which they were paid.

### **Prepay the Mortgage**

Regularly paying extra on your mortgage principal will help you pay the loan off sooner, and save you money in the long run—paying as little as \$25 extra a month can save you thousands of dollars over time. Make sure your mortgage has no penalties for paying it off early.

### **Keep Good Records of Home Improvements**

Like any other investment, if a house sells at a profit, you must pay taxes on that profit. Those profits qualify as capital gain, although you may be able to deduct any money you spend on home improvements. It is important to save all receipts for home improvements for as long as you own the house, plus three years.

A capital improvement must add to a property's value, prolong its life, or adapt it to a new use. Examples of home improvements are landscaping, wall-to-wall carpeting, wood floors, siding, and screen enclosures. Everyday repairs are not considered capital improvements.