Money

Burned out: Recovering from a fire

Wildfire destroyed one family's home. Then they learned they were underinsured. Money Magazine's Paul Keegan has the story on how they can rebuild.

By Paul Keegan, Money Magazine contributing writer
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(Money Magazine) -- Emily Martin is nine years old and quite sure of herself. So when she saw the news on television that wildfires were spreading across the San Diego area, not far from her family's home in Rancho Bernardo, she instructed her seven-year-old sister Haley to pack a bag.

The girls scampered into their rooms and placed their dolls and clothes into backpacks. When their parents saw what their daughters were up to, they laughed. Kevin and Nicole Martin had been following the news too and told the girls not to worry. The fire was not headed their way.

At four o'clock the next morning, Kevin's mother, who lived with the family, woke up. Lynn Martin, 64, still does not know why - perhaps it was "divine guidance," she says. She turned on the news, saw that the fire was heading their way, and ran to wake up her son. They looked outside and saw the sky was glowing red.


PHOTO: GREGG SEGAL

Starting all over: Nicole, Emily, Haley and Kevin Martin.

THE BOTTOM LINE

The Martins need to figure out how best to use thei insurance settlement while working to get out from under the crush of mortgage debt.

+ INCOME	
Kevin and Nicole's earnings	$ 145,410
Insurance tapped for expenses	50,000
TOTAL	**$195, 410**
- OUTGO	
Mortgage (home, condo)	$84,150
Savings	24,300
Taxes (property, income)	21,750
Apartment rent	18,000
Car (loan, maintenance)	13,440
Utilities (including phone, cable)	8,520
Entertainment, kids' activites	7,760
Groceries	7,200
Clothes, household items	6,980
Insurance (home, car, life)	3, 310
TOTAL	**$195, 410**
+ ASSETS	
Ins. settlement (minus expenses)	$1,087,000
Land value	600,000
Condo hotel suite	523,000
Retirement accounts	203,000
Stocks	107,000
Cars	45,000
Savings	20,000
TOTAL	**$2,585,000**
- LIABILITIES	
Home mortgage	$1,000,000
Condo hotel mortgage	230,000
Car loans	35,000
TOTAL	**$1,265,000**
= NET WORTH	**$1,320,000**

The evacuation drill

"Nicole, go get the girls!" Kevin yelled. They threw on clothes and grabbed what they could - a terrifying real-life version of the old parlor game, What would you take if your house was on fire? Kevin reached for his wallet, his cell phone and the family's passports. Nicole got water and snacks. Lynn took a photo album, clothes and four paintings by her father, the artist Frank Soltesz. The girls had their backpacks. In all it took 17 minutes for the family to wake up, dress and evacuate.

They piled into three cars. Suddenly, Kevin remembered Luna, their springer spaniel puppy, and ran back into the smoke-filled house to grab her. As the caravan pulled away, Lynn turned and saw that the back of the house was on fire.

The Martins had just spent three years renovating their four-bedroom home; the property, including the land, had recently been appraised at $1.4 million. It burned to the ground in less than 2½ hours. The family escaped safely but lost most of their possessions, as well as Emily's cat, Trina Tree Stump. The date was Oct. 22- Kevin and Nicole's 13th anniversary.

How does a family bounce back from such a catastrophe? Like so many victims of last fall's California wildfires - which destroyed at least 1,500 homes from Santa Barbara to the Mexican border - the Martins were devastated. In the weeks immediately following, Kevin and Nicole couldn't eat, Emily had nightmares, and Haley, the baby of the family, suddenly didn't want help from anyone.

Cracks in the financial foundation

The Martins are also facing severe financial repercussions. They were initially euphoric at receiving $1.1 million from Farmers, their insurance company, just two weeks after the fire ($785,000 of the total was earmarked for rebuilding the house). But they've since learned that the settlement probably won't come close to covering the cost of rebuilding, replacing their belongings and living in temporary housing until the work is completed.

The fire also exposed the cracks in the solid financial foundation the couple thought they stood on. They earn a comfortable living: Kevin, 38, an industrial engineer with Qualcomm, and Nicole, 37, who runs a home-based window-treatment business, make $145,000 a year.

But the couple had borrowed heavily against their house, in part to pay for a risky real estate venture, leaving them with loan payments that eat up more than two-thirds of their net income. And while they do save steadily for retirement, they have little cash on hand for emergencies. As Hal Schweiger, a financial planner in San Diego who reviewed the family's finances, put it, "They're right on the brink."

"Whenever the Martins leave the rented two-bedroom apartment where they now live to visit the ruins of their old house, they're reminded of the arbitrary nature of fate. The home just to the right of theirs sustained very little damage. Of the 271 houses in their subdivision, just 41 were destroyed. The likely cause of the fires: sparks from downed power lines.

The couple had moved to the area in 2003. It was a homecoming of sorts, since they'd met in San Diego while both were in college. After they married in 1994, they moved to Fort Collins, Colo., where the girls were born, then to Santa Rosa, Calif.

Four months after they arrived in Rancho Bernardo, the area was hit by the largest wildfire in California's history. The Martins were unfazed. Says Kevin: "You think it's never going to happen to you."

Shortly after buying their home, the couple began a major renovation. They'd gotten a great deal on the 4,500-square-foot house, knocking the price down from $870,000 to $710,000, because it was run down. Kevin did most of the work himself, putting in a patio, dividing one large bedroom into two for the girls, adding a guest bathroom and remodeling the kitchen and master bath. Cost: $100,000.

To pay for it, the Martins tapped their home equity, boosting their mortgage from $650,000 to $800,000 (they used the other $50,000 to pay off their credit cards and a car loan).

Flipping a house

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As the Martins were renovating, they made a $100,000 profit by flipping a house they'd bought as an investment in Santa Rosa. That whetted Kevin's appetite for more real estate deals. So he used part of the proceeds to help buy a $523,000 suite in the upscale Hard Rock Hotel, a condominium hotel that opened in downtown San Diego in November. To complete the purchase, they refinanced their home mortgage again, taking out $200,000 more in equity, and then got a $230,000 mortgage on the condo for the balance.

But the Hard Rock deal put a big strain on the Martins' finances. The $5,000 a month they pay on their home mortgage eats up most of the $7,750 they take home after taxes and Kevin's contributions to his 401(k) and stock-purchase plans. (The Martins already have $200,000 set aside for retirement and another $100,000 in individual stocks.)

Now they have to start paying $1,700 a month on the Hard Rock mortgage as well. Kevin is confident that bookings at the hotel will more than cover those payments. But since the hotel just opened, its occupancy rate is uncertain.

Going out on such a limb actually may have saved the Martins, however. Before approving the refinancing, the bank required them to increase their home-owners policy to cover the appraised value of the house, excluding the land ($813,000).

Reality sets in

To satisfy the requirement, the couple boosted their insurance from $450,000 to $652,000, with extended-replacement coverage that would pay up to 25 percent over the policy limit for unforeseen costs, bringing the maximum benefit to $812,500. The Martins say they believed that would cover the total bill for rebuilding, even in the unlikely event that their home was ever completely destroyed by fire.

"The day after the wildfire, Kevin returned in a police cruiser to assess the damage. When he saw what was left of the house - the concrete front steps, part of a wall and a staircase now leading nowhere - he broke down sobbing.

Over the next few days, all they'd lost began to sink in: the baby videos and photos; original paintings of Kevin as a child by his artist grandfather; Emily's special baby blanket and her cat. Nicole had been assembling a slide show to honor her mom, who'd died a year earlier. All those photos are gone. "That breaks my heart," Nicole says.

The first week was like one long day. Kevin wore the same clothes for five days. Nicole was numb. The girls were disoriented, and Haley kept saying, "I want to go home." They went to Target to buy underwear. They moved to a Marriott hotel for two weeks, then into a two-bedroom apartment (Kevin's mom is house-sitting nearby).

In all, they spent $2,000 those first two weeks on hotels, clothes, toiletries, meals and odd expenses like getting the ash washed from their cars.

But money wasn't a problem at first. Within a week of the fire the Red Cross provided $1,300 in emergency funds, a Buddhist relief agency gave them $300, and they got $5,000 from their insurer to start replacing their belongings.

Help from all sides

For every financial hit they took, someone stepped up to help. Kevin took eight days off from work, but co-workers donated their vacation days to cover it. Nicole lost all her samples of window blinds and shades, but her suppliers replaced them at little or no cost. A friend dropped off two suitcases of sweatshirts, pants and other clothes.

Best of all, despite the horror stories the Martins had heard about people fighting to get settlements after a disaster, the checks from their insurer kept coming. Just over two weeks after the fire, the Martins received $785,000 to rebuild the house, $245,000 to replace their belongings and $102,000 for living expenses during the time it would take them to rebuild.

But their delight quickly turned to dismay by mid-November after they spoke with George Kehrer, head of the nonprofit Community Assisting Recovery (CARe), a consumer-advocacy group for disaster victims. "It was a real eye-opener," says Kevin.

Underinsurance horror

Upon reviewing the Martins' situation, Kehrer concluded that they were underinsured by at least 30 percent to 40 percent. The $785,000 they received to rebuild their home, while close to their policy limit, works out to about $175 a square foot.

But, Kehrer says, constructing a custom-built house on a hillside in their neighborhood typically runs $250 to $300 a square foot, based on estimates from local builders. That would put the tab for rebuilding closer to $1.1 million to $1.35 million. And he estimates that the cost of replacing their belongings might be twice as high as the $245,000 the insurer sent them.

Kehrer says disaster victims like the Martins are in a state of shock and just grateful to get help. "If the insurer cuts a check quickly, most people never raise an eyebrow," he says. "They've never seen a check that big. Later they realize there's no way they can rebuild for that price."

The advice

Push for a bigger payout Under the terms of their policy, the Martins are entitled to get as much as $489,000 to replace their lost possessions vs. the $245,000 they received - if they can document that what they owned was worth that much money. Since the couple didn't keep an inventory of their belongings, they should put together a detailed list of the clothing, furniture and assorted other items they lost, then try to recreate documentation. They can, for example, get records of their purchases from stores and credit-card companies and also provide their insurer with photos of their possessions taken during the recent reappraisal.

The Martins could also qualify for an additional $196,000 in reimbursements apart from the house. Walkways, fences and similar structures, for example, are covered separately, for up to 10 percent of the $652,000 policy limit; upgrading the new house to meet current building codes could net them another 10 percent; debris removal could add up to 5 percent; and landscaping work is also covered up to 5 percent.

Kehrer says that the Martins even have a chance of getting compensation beyond their policy's stated benefits if they can make a case that they had good reason to believe they'd be fully covered when they bought the policy and show how much more rebuilding is likely to cost than the insurer's estimates.

The first step, Kehrer says, is to get the "scope-of-loss report," which details how the company arrived at their payout; then hire a reputable contractor to render a second opinion. This might cost as much as $5,000, but if an independent assessment concludes it would take far more than $785,000 to rebuild, the insurance company might up the payout, Kehrer says.

(Farmers declined to comment on the Martins' case, but a spokesman says the settling of claims is an "ongoing process" and confirms that the company is open to negotiation even after its initial checks have been cut.)

Hold off on rebuilding As eager as the Martins are to get going on a new home, Kehrer urges them to postpone using the insurance money they've gotten until they finalize their settlement. Not because cashing the check would close the case - in California, homeowners have two years to dispute a settlement - but because disaster victims can't make smart decisions about what type of house to build until they know for sure how much they'll have to pay for it.

If they were to forge ahead now and later win a larger settlement, the Martins would have wasted time and money on construction plans they'd probably end up scrapping.

Slash the mortgage debt Even before the fire, the Martins were living dangerously because of the staggering $1.2 million they're carrying in mortgage debt. Says Schweiger: "If, say, Kevin were to get laid off, they'd really be in trouble."

The best way out: Sell the Hard Rock Hotel suite, Schweiger urges. After paying off the hotel mortgage, they'd still have $290,000 left, which they could use to pay down nearly a third of their home mortgage. That would save the family $1,300 a month, making it much easier to stay on top of their bills and set more money aside for emergencies (the goal, Schweiger says, is to boost their short-term savings from $20,000 to $50,000).

Bonus: They wouldn't have to worry about how they'll pay the Hard Rock mortgage if bookings of their suite fall short of expectations.

Spread the wealth Schweiger wants to make sure the Martins don't neglect their long-term goals as they struggle with their current crisis - goals like putting the girls through college and retiring by age 55. But, he says, those plans are threatened by the lack of diversity in the Martins' portfolio, which puts them at risk of higher-than-average losses if the market turns against them. About 70 percent of their individual stocks, for instance, are in shares of Qualcomm (Charts, Fortune 500), Kevin's employer, making the family's financial fate too closely linked to the fortunes of one company. And nearly a third of Kevin's 401(k) is also in individual stocks.

A better idea, says Schweiger: Dump the individual stocks in the 401(k) and stick with a mix of mutual funds - 80 percent in equity funds and 20 percent in fixed income. And while buying Qualcomm stock makes sense because Kevin gets a 15 percent employee discount, he should sell those shares quickly and reinvest the money along the same lines as his retirement account.

Assuming the investments earn historical rates of return and the Martins keep saving at their current rate, this plan should enable them to retire at 55 and pay the $275,000 or so that it will likely cost to send Emily and Haley to a public college.

Back at the ruins of their former life, the Martins are starting to get excited about building a new home - after they finish wrangling with the insurance company. "I'd like to have a three-car garage and a workshop," Kevin says, tromping through the wreckage. "Here we'll have stairs going up to two bedrooms for the kids, a bathroom and maybe a loft..."

The Martins are grateful for the advice from Kehrer and Schweiger and have begun the painstaking process of itemizing all their lost belongings. But Kevin has little interest in selling the suite at the Hard Rock, which he's convinced will pay off in the long run. In other areas, though, he's now not nearly as prone to taking risks. For one, he has promised not to laugh at his daughters next time they pack their bags and leave them by the door. ■