RISKY BUSINESS

by Kristin Gunderson Hunt

IREM Members and Experts Discuss the Importance of Property Insurance for Disaster Preparedness

Property insurance can make or break real estate management companies, depending on their coverage in the event of a disaster—whether it's a hurricane blowing in from the coast town, a flood unleashing its wrath or an earthquake rattling windows and walls.

Yet, the complicated nature of property insurance, along with the multitude of other responsibilities real estate managers face, hinders many from investing the time and resources needed to ensure their properties are adequately protected.

"The problem with insurance is it keeps you up at night and you don't know why," said Lou Nimkoff, CPM®, president of Brio Properties in Winter Park, Fla.

He said many real estate managers, particularly those at small management companies, are "defacto" risk managers, thrown into the responsibility of determining a property's level of risk and finding adequate insurance to mitigate that risk.

"Insurance is very legal and very detailed," Nimkoff said. "Most of us are asked to take on the duty when we're ill-prepared to do so."

Being prepared means understanding the types of coverage available, the coverage a property already has in place or needs, exclusions in policies that can be damaging, and how to handle insurance claims in the event of a disaster.

PREVALENT PERILS

Should disaster strike, the major form of insurance on most real estate managers' minds is property insurance.

Standard property insurance protects against risks to a property, such as fires, some weather damage and theft. Coverage for floods, earthquakes and windstorms is often available via an endorsement to a property policy or as an entirely separate policy.

Property insurance can come in the form of an all-risk policy, also called an open peril policy, whereby all the causes of loss are covered unless they are specifically excluded; or a named peril policy, which covers only specifically listed risks.

All-risk policies are the most broad and comprehensive, said David Mistick, CPM, president of Circumspex LLC, a company that provides a web-based disaster planning and recovery application for property managers. He said the only reason companies would select a named peril policy is if a risk is expressly excluded in their all-risk policy.

"If the all-risk policy excluded flood or earthquake, the property owner would want to buy a named peril policy to cover these if he was exposed to those risks and the likelihood of occurrence was significant, said Mistick."

Named perils like flood or earthquake are limited in sales and coverage. For example, flood is all underwritten by FEMA but distributed by private insurance companies. Earthquake is often underwritten by risk pools of companies to spread the exposure.

As far as limits go, wind, earthquake and flood limits are based on models that analyze a location's susceptibility to particular disasters and estimate a probable timeframe for the next occurrence. Clients usually buy to the 250-year event level for earthquake and wind, based on the probability, according to Al Tobin, managing director and national property practice leader for Aon Risk Services in New York.

He shared that fire limits are set against values in the simplest way: For example, if your largest building has replacement cost and rents of $100 million, $100 million may be your limit. Lenders might also require a certain limit based on any building debt.

"A property manager, with a broker's assistance, should be able to acquire the right combination of coverage," Mistick said. "The key will be getting them at a price that fits the budget."

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—MIKE HALVEY, REAL ESTATE PRACTICE LEADER FOR ZURICH NORTH AMERICA

INDECENT EXPOSURE

Deductibles are of course a big part in deciding what fits the budget. Different deductibles apply to different disaster perils, said Ann Butterworth, director of property underwriting in Weston, Mass., for Liberty Mutual Property. Some are percentage based, where one pays a percent of the loss, and others are a flat amount that must be paid upon a loss.

Regardless, Butterworth said owners and managers need to take into account the deductible when budgeting and determine if they could afford to be financially responsible at that level if a loss was to occur.

Acquiring adequate property insurance at the right price hinges on a thorough assessment of portfolios, the appropriate valuation of properties, and owners' and managers' appetite for risk.

"There is no right or wrong," Nimkoff said. "It's a property by property and owner by owner strategy."

Owners and managers should assess a multitude of variables when determining risks to a property, such as the proximity of a building to a chemical plant that could have a spill, the possibility of a property being targeted by terrorism, the use of their buildings and the associated risks with those uses, and the geography of their properties and whether they are in areas prone to natural disasters.

"The insured should know where their exposures are and what perils they are subject to," Butterworth said.

Aside from an owner's or manager's analysis of a property and its risk, insurance companies have modeling tools that will help determine a property's risk profile.

"One of the most popular of these tools is Risk Management Information Systems," Tobin said. "Both earthquake and windstorm are very technical products, and your broker should be giving you direction as to what type of limits are available to be purchased based on your modeling."

Just as important as determining a property's risk profile is determining a property's value, which is the replacement cost value, Butterworth shared. It is important not to make the mistake of thinking a property's market value and replacement cost value are the same.

"If you want to be truly indemnified, having the appropriate values is important," she said.

Charles Bauroth, account engineering manager at Liberty Mutual Property, also in Weston, Mass., said companies should do a valuation of their properties every three to five years. He suggested an outside appraisal service do the valuation for accuracy. He also shared that managers need to be aware of how their portfolio changes annually, taking into consideration whether any new properties have been added, whether they've been reported to the insurer, and where those new properties are located.

Once valid risk profiles and values are in place, owners and property managers, along with their broker, should determine the level of coverage that would be most appropriate.

"There is a universe of different types of coverage you can get out there," said Mike Halvey, real estate practice leader for Zurich North America. "The question to ask is, 'how exposed are you right now?'"

GAPS IN COVERAGE

Owners and managers need to assess their risk tolerance to determine if they are at ease with their policies, said Halvey. They should also understand what their out-of-pocket costs would be in the worst-case scenario—a total loss—and ask themselves if they are comfortable with that amount.

Policies need to be scrutinized for gaps in coverage and exclusions so those items can either be negotiated, or supplemental coverage can be purchased to ensure assets are fully protected in the event of a disaster.

One area to consider is whether a property's landscaping would be protected under the policy, whether there would be specific limits per tree or shrub, or if a flat sublimit would exist for all the landscaping. For properties with green rooftops, it should be taken into consideration if the entire vegetative roof would be covered in a loss.

For companies that acquire properties on a regular basis (between property policy renewals) newly acquired location coverage protects any properties added to a portfolio despite not being accounted for when the policy was initially put in place. Exclusions like California earthquakes or Florida wind should be noted if the new properties might be impacted by those events.

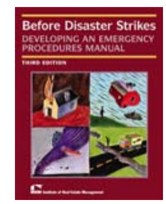
Ordinance or Law Coverage is another key component to consider in a property policy. In many jurisdictions, the insured must pick up any additional expenses incurred with renovating or rebuilding a property up to code with local ordinances or laws, even if the cause of loss is covered by the policy.

Owners and managers can get into trouble if their projected replacement cost value only accounted for building or renovating to original, and probably less expensive, standards. The ordinance or law endorsement covers the expense of updating the property to any building, zoning or land use laws, since restoring a building to its previous condition is disallowed if it is not up to code.

Other coverage property managers sometimes consider to further protect their assets in the event of a disaster include service interruption, tenant emergency evacuation, as well as tenant relocation and move-back expenses, which pay for the moving costs of tenants who temporarily vacate a building due to damage from a disaster that is covered by the insurance.

Halvey said knowing and understanding a property policy is critical to avoiding surprises down the road.

"When things aren't covered, it's not



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as if it's just something hidden in the small print," he said. "It's just understanding what's in the contract."

CLAIMING IGNORANCE WON'T HELP

Understanding what's in the contract goes a long way when the time comes to actually file a claim. Some claims are denied solely because filing stipulations laid out in the policy weren't followed, often because the insured was unaware of the stipulations.

A common stipulation is that a claim must be submitted within a certain period of time. Some policies require insureds to provide insurance carriers with certain information before they are even allowed to contain the loss, Mistick of Circumspex said.

Not readily having that information could stall the loss containment process, which can be costly. Mistick saw a loss jump from $400,000 to $1.3 million because a building went unattended while insurance issues were being worked out. Additionally, in the event of a fire, damage costs can be reduced by between 30 and 40 percent, if promptly contained.

"Having an organized to-do list can have a huge impact on property loss and the amount of time you spend out of commission," Mistick said.

Tobin also emphasized the importance of having a plan for filing claims, and said calling the broker is usually the first step.

"It's important to have some type of procedure in place for claim filing purposes as to make sure your property—whether it's commercial or residential—continues to generate revenue," Tobin said.

He added that having a good broker to call and walk you through the process is a valuable asset.

"Claims are never easy," Tobin said. "You need to have a good advocate on your side."

MAKE THE PIECES FIT

Good brokers are also valued assets beyond the claims process, because they can help you find your way around the risk management and insurance process, Butterworth shared.

Halvey said owners and managers should ensure they have a quality broker by asking: What percentage of their book is comprised of commercial real estate? How long have they been writing this type of business? And how many accounts do they have in this line of business?

Just as a good broker is needed, a good insurance carrier is needed too. Know the carrier's claims philosophy and whether or not the carrier has a reputation for being aggressive or reasonable when it comes to denying or covering claims, Halvey said. Consider whether the carrier has a catastrophe unit that will come on site in the event of a disaster. Review the carrier's history, too. Did it weather the storm after the last disaster or did it exit the market? Will it be around when you need a claim paid?

"It's not just price. It's what the insurance company brings to the table in terms of services and its ability to help you with disaster planning beforehand," Butterworth said.

And while being able to rely on a broker and carrier is important, real estate managers and owners also need to rely on their own disaster planning to further protect their assets. Being proactive can keep the losses from being larger, allowing the insurance to go further.

"The pre-planning (owners and managers) do benefits them multifold," Butterworth said.

Mistick believes the value of a disaster plan cannot be dismissed as it addresses risks and offers direction, property insurance is really part of the disaster plan and not a remedy for a plan not being in place.

"Property insurance is truly one of the pieces to the puzzle of being prepared," Mistick said. ■

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Kristin Gunderson is a contributing writer for *JPM*. If you have questions regarding this article or you are an IREM Member interested in writing for *JPM*, please e-mail Markisan Naso at ***mnaso@irem.org***.