



Property Insurance

ROLE OF PROPERTY INSURANCE

Insurers are in the unique position of having encyclopedic information about the many different ways your business property could be damaged or destroyed, from fire and flooding to embezzlement. Property is also vulnerable as a result of a variety of other events such as electrical surges, accidental activation of a chemical sprinkler system or a computer virus.

Because insurers know so much about what can go wrong, they can provide your business with the insurance coverages your particular type of enterprise requires. Without appropriate insurance, property losses can easily cause the entire enterprise to fail.

The purpose of property insurance for the small business is to provide critical financial assistance in the event of a loss, so that the enterprise can continue to operate with as little disruption as possible.

Property insurance alone is seldom enough, however. It should be but one part of an overall risk management and disaster recovery plan. On average, businesses that devote resources to risk reduction and risk control have fewer insurance claims. Firms with a good record on claims generally have more insurers competing for their business, so that they are able to find coverage more easily and often at a lower price than companies that have more losses.

We cover here, in a general way, many of the more common types of property coverage. You can obtain full information about your particular policy by reading the policy itself and discussing your coverage needs with your agent or insurance company.

PROPERTY INSURANCE POLICIES

Insurers offer small business owners a huge variety of property insurance policies. There are policies that cover only a single peril, or cause of loss, such as a fire insurance policy, a crime policy or an electronic equipment policy. The particulars of the policies vary from insurer to insurer.

And there are policies that include several different coverages in a single “package.” The majority of small business owners find it more convenient and economical to purchase a package policy, which provides protection against many types of loss in a single policy. Insurers may create their own insurance policies. Many rely in part on a package policy format from ISO. This policy is generally referred to in the insurance industry as the Business owners Policy (BOP). The BOP is revised periodically. The discussion here is based on provisions of the 2004 revision to the BOP.

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PROPERTY COVERAGE IN THE BOP

The BOP covers any buildings the business owns and much of the property needed to run the business.

Specifically, the policy covers:

- Buildings as named in the policy "Declarations," generally the first pages of the policy. Structures are covered as well as permanently installed fixtures, machinery and equipment; outdoor fixtures; items you use to maintain or service the building, such as appliances; and additions under construction. You can choose to insure your buildings at their "actually cash value"—what they are worth—or their "replacement cost"—what it would cost to replace them with new construction. To keep up with the increasing cost of rebuilding, the policy's limit of insurance for covered buildings will automatically rise by a set percentage each year. Be sure to discuss with your agent whether you should purchase the standard building coverage or replacement cost coverage.
- Building contents, although there are a few exceptions. The policy covers most property on or near the business premises that is used in the business. This would include such things as machinery, computers, raw materials or inventory. You also have coverage for any leased property, which you are contractually obligated to insure.
- Property of others that is in your care, custody and control to the extent you are legally liable for that property. This coverage is particularly important to a business, such as a computer repair shop, that earns revenue from servicing the property of others.

WHAT ABOUT A BUSINESS THAT LEASES OR RENTS ITS PREMISES?

If your business rents or leases its premises, your lease should describe your obligations with respect to insurance. If you are the sole tenant, you may be responsible for insuring the building. You may be responsible for continuing to pay rent even if the building is destroyed. Should a fire destroy the building, will the landlord or the tenant be responsible for debris removal? You may want to review your lease with your insurance agent to be sure your property insurance covers your obligations.

For those who rent, the BOP provides coverage for tenants' improvements and betterments. These are fixtures, alterations, installations or additions that you have put into the space.

COVERED CAUSES OF LOSS

Insurance contracts always describe in some way the perils being insured against. One type of BOP names the covered causes of loss. Another uses what insurers may call the "special form," which states that all causes of loss are covered except those that are excluded by name. Because the special form provides broader coverage, premiums for this type of BOP may be higher.

In the BOP format that names covered causes of loss, those included are fire, lightning, most explosions,

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windstorm or hail, smoke from accidental fire, aircraft or vehicles (not including those owned or operated by the business itself), riot or civil commotion, vandalism, automatic sprinkler leakage, sinkhole collapse, building collapse, volcanic action and certain types of damage from water or other liquids.

CAUSES OF LOSS THAT AREN'T COVERED

A number of events that can cause property loss are not covered by the basic BOP. Some, such as employee dishonesty or breakdown of a steam boiler, are excluded from the basic BOP, but you can add coverage to it by payment of an additional premium. Some events, such as wear and tear, aren't covered because they don't meet the basic criteria for insurance of being accidental and unpredictable. (Regular maintenance of property is your responsibility.) Coverage for other events, such as flood and earthquake, aren't needed by all businesses. Separate policies are available. Nuclear reaction and war are considered to be uninsurable, since insurers cannot predict with any degree of accuracy the frequency of such events or amount of damage likely to occur.

The following are some of the other events that can cause damage that are usually excluded from the basic BOP: power failure (except when it causes loss or damage to computers and electronic data); failure of computer hardware or software; robbery and burglary; most instances of pollution; and changes in humidity or temperature. Also excluded is coverage for missing property where there is no physical evidence to show what happened to the property, such as with a shortage discovered after taking inventory.

Be sure you understand what causes of loss are and aren't covered by your policy. Discuss with your agent the extent to which your business risks a loss from any of these excluded events and whether you should purchase coverage for these particular risks if it is available.

PROPERTY THAT ISN'T COVERED

The basic BOP excludes some types of property from its coverage. For many of these items, such as money and securities or outdoor signs, insurance is available as an addition to the BOP for an additional premium. For items such as motor vehicles or boats, however, you will need to purchase a separate policy. Excluded property usually includes:

- Any vehicles subject to motor vehicle registration, including aircraft, autos and trucks
- Bullion, money or securities
- Land, water, growing crops, lawns, trees, shrubs or plants
- Outdoor fences and signs not attached to the building

You should discuss with your agent what property is and isn't covered by your policy, as well as whether you may need to purchase additional coverage for some types of property excluded from the basic BOP coverage. Since most businesses, for example, own or use vehicles, they should consider business automobile insurance.

IS THERE ANY COVERAGE FOR POLLUTION?

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Coverage for pollution is limited to cleaning up pollution that was caused by a covered cause of loss occurring during the policy period. For example, if vandals opened drums of a toxic chemical and poured it on the ground, the insurer would cover the cost of the cleanup, up to the policy limit, since vandalism is a covered cause of loss. On the other hand, if the toxic chemical slowly leaked into the ground because the drum was defective and had a tiny hole in it, you would not have coverage under the BOP. A defect in the drum is not a covered cause of loss under your property policy. (For help with cleanup costs in this hypothetical situation, you might find compensation from the liability insurance of the drum manufacturer or seller of the chemical.)

BUSINESS INCOME AND EXTRA EXPENSE COVERAGE

If your main business premises are destroyed along with much of the property you used to operate, this loss, though devastating, may be only just one part of the total. You should consider purchasing Business Income and Extra Expense Insurance (also known as Business Interruption Insurance).

Every day you are unable to operate is a day of lost income, for you personally and for the business. If the property damage or loss prevents you from providing products or services to your customers or clients, they may go elsewhere and many of them may never return. If you are to keep your employees, you must continue to pay their wages, even when the business is generating much less than normal income. It is little wonder that many businesses that lack insurance to cover the potential ongoing economic effects of a serious destructive event are unable to survive. A survey by the National Association of Insurance Commissioners found that only 35 percent of small businesses, defined as firms with fewer than 100 employees, have business interruption insurance.

Prudent businesses have disaster recovery plans that include insurance to cover lost income and extra expenses that can result from getting back on track after a covered loss.

Because coverage for lost income and extra expenses is so important to continued business survival, it is part of the standard BOP. The policy covers actual loss of net business income that would have been earned had it not been necessary to suspend operations due to a covered cause of loss. The policy also covers continuing normal operating expenses such as utility payments and payroll.

The insurer will pay, as well, extra expenses that you incur to avoid or minimize the suspension of operations. Such extra expenses often include costs to relocate, and to equip and to operate replacement premises, as well as expenses to repair or to replace property and to restore lost information on damaged valuable papers and records.

Generally, these coverages are triggered only when you have a direct loss from a covered cause of loss. If the cause of loss is an earthquake, there will be no coverage under the BOP. If your business must be closed due to someone else's loss, there is no coverage. For example, your business could be an accounting firm located on



the third floor of a large building. If there is a fire on the ground floor of the building, which does no damage in your office but causes the building to be shut down for repairs for a month, your BOP would not provide coverage for lost business income and extra expenses, since you did not have a direct loss yourself.

SEASONAL VARIATIONS IN VALUE

Your business may be one of the many that experience seasonal variations in the value of inventory, raw materials and other items. A complete loss at the height of the summer if you sell ice cream or during the winter holiday season if you have a retail operation may be several times larger than during the rest of the year. To protect against a loss in the busy season, the BOP provides for an automatic 25 percent increase in your policy limit for business personal property. The seasonal escalator applies only if you have insured your business personal property to at least 100 percent of your average monthly values during either the 12 months preceding the loss or the period of time you have been in business as of the date of the loss, whichever is less.

OTHER LOSSES AND EXPENSES COVERED BY THE BOP

The BOP includes numerous other coverages to protect your business from a variety of accidental events that could wreak havoc on your financial well-being. These include:

- Actions of Civil Authorities
- Bogus Money Orders and Counterfeit Money
- Contingent Business Interruption
- Computer Operations Interruption
- Debris Removal
- Electronic Data Loss
- Expense to Preserve the Value of Property
- Fire Extinguisher Recharge
- Forgery or Alteration
- Fungi, Rot and Bacteria
- Window Glass Breakage Expenses

Actions of Civil Authorities – Sometimes physical damage to property other than your own leads the police or other civil authorities to prevent you from having access to your own premises. If the loss at the other property is due to a cause covered by your policy, then the insurer will pay for your actual loss of business income and any necessary extra expense caused by the action of civil authorities. By way of example, assume you own a hair salon. An explosion has significantly damaged other businesses near you, although your own premises suffered no physical damage. The police close off the whole block for a week, preventing your business from operating from that location. Your insurer will cover your lost income and extra expense caused by this action.

Bogus Money Orders and Counterfeit Money – Should your business make the good faith mistake of accepting bogus money orders or counterfeit money, the insurer will pay up to \$1,000 to cover the loss.



Contingent Business Interruption – This coverage, which may also be called “Business Income from Dependent Properties” or “Contingent Business Income,” applies when your business is dependent on another operation and the other operation is unable to conduct its usual business because it has been damaged by a cause of loss that is covered by your policy. Should you suffer a loss due to such damage at the premises of a business you depend on (“dependent property”), the insurer will pay for the actual loss of business income you sustain. For example, you’ve designed a new type of folding beach chair and you have many orders to ship it in time for the summer selling season. Your chairs are manufactured at the Contract Furniture Factory (CFF). Due to damage from a fire, CFF is unable to make your chairs. Should neither you nor CFF have a backup manufacturer who can fulfill the contract, you will lose income from the orders you cannot ship. Your insurer will pay for the net income loss you suffer as a result. If, however, damage at CFF is due to an earthquake and you don’t have earthquake insurance this coverage will not apply since the damage at the dependent property was not due to a covered cause of loss.

Computer Operations Interruption – Should computer operations be interrupted due to a covered cause of loss; your insurer will pay up to \$10,000 for business income lost and extra expenses incurred as a result of the computer problem. In addition to other causes of loss, this coverage applies to a loss caused by a computer virus, harmful code or other harmful instructions entered into your computer system or a network to which it is connected. There is no coverage; however, for loss or damage caused by the actions of any employee, including temporary or leased employees, or by anyone you hire to work on your computer system.

Debris Removal – When a building is destroyed or damaged by fire, wind or other peril, debris is left that must be removed before reconstruction can occur. The business policy, within certain conditions, covers the cost of removing debris left behind as a result of a covered cause of loss. There is an extra \$10,000 of coverage for debris removal should the limit of insurance be reached before debris removal has been factored in.

Electronic Data Loss – In the event electronic data is destroyed or damaged as the result of a covered cause of loss, the insurer will pay the cost to replace or restore it. Causes of loss that apply to this coverage include a computer virus, harmful code or other harmful instructions entered into your computer system or a network to which it is connected. The coverage applies as well to cyber extortionists who threaten to bring your computer system down with a code or virus if you don’t meet their demands. There is no coverage; however, for loss or damage caused by the actions of any employee, including temporary or leased employees or by anyone you hire to work on your computer system. (Negligent work by third parties should be covered by their liability insurance.)

Expense to Preserve the Value of Property – To preserve the value of property, it may be necessary to move it from the insured premises to another location. For example, if a major storm is predicted and your building has no basement, you may want to move some of your high-value inventory to a safer location. The property



policy covers such property while it is being transported and for up to 10 days after it is moved to the alternative location.

Fire Extinguisher Systems Recharge Expense – If your fire extinguishing system is discharged (other than during installation or testing), the insurer will pay to have it recharged or replaced, whichever costs less.

Forgery or Alteration – The insurer will pay up to \$2,500 (unless you buy a higher limit) for losses resulting directly from forgery or alteration of any check, draft, promissory note or similar promise of payment in money that you or your agent issued or that someone impersonating you or your agent issued.

Fungi, Rot and Bacteria – Your BOP insurer typically limits the situations in which it will pay for loss or damage caused by fungi, wet or dry rot, or bacteria. Usually, the insurer will pay up to \$15,000 only when the underlying cause of the damage is a specified cause of loss other than fire or lightning that occurs during the policy period and only if you used all reasonable means to save and preserve the property from further damage at the time of and after that occurrence.

Window Glass Breakage Expense – Where glass has been broken, the insurer will pay expenses to put up temporary boards if repair or replacement of damaged glass is delayed.

ADDITIONAL COVERAGES YOU MAY NEED

The standard Business Owners Policy (BOP) recognizes that some types of coverage are important for some customers but not for others. It makes provision for adding coverage through what insurers may refer to as "optional coverages," coverage extensions and endorsements. These are among the coverages you may choose to add to your BOP with the payment of an additional premium:

- Accounts Receivable
- Adding Additional Insureds
- Burglary and Robbery
- Computer Fraud and Funds Transfer Fraud
- Earthquake and Volcano Coverage
- Employee Dishonesty
- Food Contamination
- Mechanical Breakdown
- Money and Securities
- More Coverage for Valuable Papers, Records and Electronic Media
- Newly Acquired or Constructed Property
- Outdoor Property
- Outdoor Signs
- Personal Effects
- Personal Property Off Premises
- Spoilage Coverage

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- Utility Services—Direct Damage
- Valuable Papers and Records
- Water Back-up and Sump Overflow

Accounts Receivable – As part of your risk management plan, to the extent feasible, you should keep backup copies of your accounts receivable in a separate location. For some businesses, however, it may be in the nature of the business that accounts receivable records are vulnerable to property loss. If needed, you may extend coverage under your BOP. The accounts receivable extension obligates the insurer to pay amounts due from your customers that you are unable to collect. The limit is up to \$10,000 per occurrence for records located on the premises described in the policy "Declarations" or \$5,000 for records located elsewhere.

Adding Additional Insureds – In many situations, a business is required by contract or law to add coverage to its BOP for other parties who usually have property at risk that is in the care of the insured. Such parties typically include managers or lessors of a rented or leased premises and mortgage holders. You can add coverage to your BOP with an Endorsement Adding Additional Insureds.

Computer Fraud and Funds Transfer Fraud – Your business may run the risk that someone will cause an unauthorized transfer of funds from your bank account, whether through electronic or written instructions. The Endorsement for Computer Fraud and Funds Transfer Fraud covers this risk. The insurer pays for the loss of money and securities resulting directly from a fraudulent instruction instructing a financial institution to transfer, pay, or deliver money or securities from your “transfer account.” The endorsement defines a “transfer account” as “an account maintained by you at a financial institution from which you can initiate the transfer, payment or delivery of money and securities.”

Burglary and Robbery – If your business has high-value goods that are attractive to criminals, loss control will go a long way to reducing the threat of theft or burglary. Optional burglary and robbery coverage, however, may be a wise part of the risk management plan.

Burglary means taking of property from inside the described premises by a person unlawfully accessing the premises as evidenced by marks of forcible entry or exit. Robbery means unlawfully taking property from a person who has the property in his or her care and custody.

The insurer covers the property on the business premises, while it is at a bank or savings institution, when it is in the custody of any employee or business owner in his or her living quarters or while it is in transit between any of these places.

Coverage is limited to \$2,500 for furs, watches, jewelry, precious metals, patterns, dies, molds and forms. If additional coverage for such property is needed, it can be purchased separately.

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Earthquake and Volcano Coverage – You may add this endorsement to your BOP to protect your business property from losses due to these perils. A different method of calculating deductibles, as a percentage of the coverage rather than as a flat dollar amount, may apply to this coverage.

Electronic Commerce – If your business relies on e-commerce—that is, business activity conducted over the Internet—you may want to add the Endorsement for Electronic Commerce to your BOP. The insurer covers your lost income and extra expenses in the event your ability to conduct e-commerce is slowed down or stopped due to the causes of loss covered by the BOP. The endorsement also provides coverage for the cost of reconstructing electronic data if it is lost due to a covered cause of loss or if it is stolen by someone other than an employee, volunteer worker or contractor.

Employee Dishonesty – Burglary and robbery insurance does not cover losses caused by employees or authorized representatives who commit dishonest acts. Employee Dishonesty Insurance provides this coverage.

Most experts agree that business owners tend to greatly underestimate their vulnerability to theft by their own employees. According to the Association of Certified Fraud Examiners (ACFE), the average business loses 6 percent of its total annual revenue to employee fraud. The ACFE says smaller companies, particularly those with fewer than 500 employees, are most susceptible to these losses. Virtually any business with employees is at risk of losses caused by employee dishonesty. As with other causes of loss, effective loss control measures can go a long way toward reducing this loss exposure.

Employee Dishonesty Insurance covers losses caused by temporary or leased workers as well as employees. Many employee fraud schemes go on for years before they are detected. If you have added this coverage to your BOP, your insurer will pay for a covered loss or damage sustained during the policy period and discovered no later than one year from the end of the policy period.

Food Contamination – If you are involved in a food business, there is always some risk that food you sell could cause food poisoning or transmit a communicable disease from an employee of your business. This risk can, of course, be reduced and controlled by following a good risk management plan, but it can never be totally eliminated.

The Endorsement for Food Contamination provides coverage for most of the expenses you would incur if food you sold caused food poisoning or disease. Coverage includes the cost of additional advertising to restore your reputation.

Mechanical Breakdown – This option provides coverage for mechanical or electrical breakdown to your boilers, pressure vessels, refrigeration systems, piping, and mechanical and electrical machines or apparatus that

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generate, transmit or simply use mechanical or electrical power. For many businesses that depend on such equipment, a breakdown means the inability to operate and loss of income. If you run a sawmill and the saw breaks down, for example, you're effectively out of business until the saw is repaired. Mechanical breakdown coverage might be a wise investment to cover this type of risk.

Money and Securities – You have the option to add coverage for money and securities to your policy. The insurer covers the property on the business premises, while it is at a bank or savings institution, when it is in the custody of any employee or business owner in his or her living quarters or while it is in transit between any of these places.

More Coverage for Valuable Papers and Records – As part of your loss control plan, to the extent feasible, you should keep backup copies of records in a separate location and valuable papers in a fire proof safe or a bank safety deposit box.

For some businesses, however, it may be in the nature of the business that certain valuable papers and records are vulnerable to property loss. Should you lose valuable papers and records as the result of a covered cause of loss, your basic BOP will pay the expense, up to your policy limit, to reconstruct the records.

If needed, you may add more coverage to your BOP for the cost to reconstruct valuable papers and records, including those that exist on electronic media. The covered property includes documents, manuscripts and records (including abstracts, books, deeds, drawings, films, maps or mortgages). It also includes electronic data processing, recording or storage media; data stored on such media; and programming records used for electronic data processing or electronically controlled equipment.

Newly Acquired or Constructed Property – If your policy covers buildings, you may extend the coverage to newly acquired buildings intended for similar use as the insured building or as a warehouse. This coverage also applies to new buildings while being constructed on the premises described in your policy. Any newly acquired business personal property is also covered. This is temporary coverage that provides time to report the new property to your insurer. The coverage expires 30 days after you acquire the property or begin construction.

Outdoor Property – You may extend your policy's coverage to apply to outdoor items, including signs, fences, shrubs and plants, and satellite dishes. Debris removal of these items is included. The most the insurer will pay under this extension is \$2,500 and not more than \$500 for any one tree, shrub or plant.

Outdoor Signs – For some business owners, the only outdoor asset not covered by their basic BOP that they wish to insure is outdoor signs not connected to their building. The BOP provides an option to add just this coverage.



Personal Effects – You may extend your coverage to apply to personal effects owned by officers, managers and anyone who works at the company. There is a \$2,500 limit on this coverage. It does not apply to loss or damage by theft.

Spoilage Coverage – If you are in a business that involves supplies, inventory or other materials that must be maintained under controlled temperature or humidity conditions for preservation and that are susceptible to loss or damage if the controlled temperature or humidity conditions change, you will probably want to add the Endorsement for Spoilage Coverage to your BOP. The covered causes of loss are mechanical breakdown of your refrigeration or humidity control system and power outages due to conditions beyond your control. The insurer will cover the cost of property that is spoiled by these causes.

Utility Services—Direct Damage – Loss of water, communication or power service could be costly to many businesses.