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Identifying risks and implementing insurance programs designed to provide financial protection - by Spencer Macalaster

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There are many aspects of risk that real estate firms face today in the course of acquiring, selling, managing, developing or redeveloping property. It is critical for a real estate owner to identify the risks and work with your insurance experts to design, negotiate and implement insurance programs that meet the exposures. Real estate firms spend a significant amount of money to mitigate risk through protection (such as sprinklers or central station alarm systems) as well as crafting contractual language to help transfer their liability exposure. This may address some of the exposure but not all. The key is to dovetail construction, environmental and modeling to create a holistic solution. This approach is then used to implement insurance programs designed to provide financial protection working in conjunction with the contractual protection.

As with any model, it's all about data. The principal factors considered are geography, replacement cost values, personal property and business interruption, type of construction, type of occupancy, year built, number of stories, new construction or renovation and type of fire protection.

Details matter. For example, type and age of the roof, roof geometry, and roof top mechanical and electrical equipment anchoring are important data to include. Are sprinkler systems in place? Does it have a central station fire alarm system that's linked directly to the fire department? Are there extenuating protections that exist for the property?

Is the property commercial or residential? Does the property have any significant historic aspects that must be taken into consideration? Most commercial properties have lower replacement values than residential projects where the cost to build out kitchens and bathrooms tends to be higher. On the commercial end, a biotech lab space will be more expensive to insure than a warehouse. For historic properties particular attention to materials and methods used in their construction are critical. The craftsmanship used in historic construction is a dying art. Architectural materials such as hand hewn timber, specialty brick, specialty tiles, or exotic wood are unique and difficult to replace.

How much has the cost of construction materials risen in the last year? Can the artisans be found to repair and replace the property to its like kind condition? What is the inflationary effect on the price of materials? Does the policy contain the appropriate replacement cost language given any unique nature of the real estate? Are you working with replacement cost values that are different than the appraised value or the bank's loan value? Are there extenuating circumstances that could delay the reconstruction of the damaged property? Would the property require government approval before occupancy can begin?

Finally, location is critical in assessing exposure. If a property is located adjacent to waterfront, or in Gulf Coast where hurricanes and construction techniques can impact coverage. In California, developers contend with earthquake exposure and must account for the added cost of construction that can withstand the effects of an earthquake. And if a property owner has multiple buildings in a specific geographic area all exposed to a single event, then it's important to look at the aggregate exposure to all loss when making insurance decisions.

Designing policy language that protects your financial interests is of utmost importance. The words of a policy are critically important to making sure the appropriate coverage is in place. Each carrier and each policy is written with language that must be carefully reviewed and corrected to assure coverage meets your needs. We recommend utilizing third-party services to model programs help estimate replacement costs to assure appropriate property valuation. Modeling can help you understand your exposures and can also be an effective negotiating tool against a carrier's modeling to make sure you end up with the best insurance program for you. Combining the correct policy language with accurate valuations provides the greatest protection in the event of a loss. Working closely with your insurance broker will assure you achieve the greatest level of protection and financial security from your insurance policies. And when insurance issues become obstacles, an experienced insurance broker, who has been there and seen that, can help find the acceptable common ground that keeps your risk manageable while moving things forward so you can deliver the quality of services you strive to offer.

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