Risk Management

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Preparation for the hurricane season includes insurance and risk reviews

Once again, the Atlantic hurricane season is upon us. With it comes a sense of apprehension for all along the coast, especially for those in the hospitality industry. For many, a few months’ income will make or break a business, so a severe storm brings potential ruin for a business that is not sufficiently insured. While business owners cannot predict a storm, they can protect their businesses financially; understanding both the insurance product and a business’ risk is essential.

Benefits that protect a business from loss caused by physical damage to the business property

The first step in assessing a business’ risk and the insurance coverage needed is to make an exhaustive list of all the property, indoor and outdoor, which must be insured. This list should include structures, machinery, fixtures, furnishings, contents and inventory. Once the list is complete, a business must estimate the replacement cost of the items it intends to insure. Accuracy is essential, as the amount of coverage purchased will limit a business’ recovery.

- For buildings and structures, replacement cost is not necessarily the equivalent market value or new construction cost. Following a storm, repair costs are often 20% to 45% higher than costs for new construction not impacted by a catastrophe. Debris removal, specialized work to dry out walls, new building codes and temporarily high prices in the wake of a catastrophe are a few of the factors that significantly increase repair costs.

- Furnishings, fixtures and inventory should be estimated at the cost to purchase an item of comparable quality on the open market, including sales tax, delivery, assembly and installation. Inventory should be estimated at its peak.

- Pair and set coverage usually provides that if damaged furnishings are part of a set, the insurer will pay the fair proportion of the set’s total value or the full value of the set, provided the undamaged articles are given to the insurer for salvage. If a business chooses to purchase this coverage, the amount purchased should accurately reflect the set’s replacement cost.

- Standard hotel policies offer guest evacuation and relocation coverage, as well as coverage for guests’ property. If a business caters to particularly wealthy guests or serves a large number of guests, it should be reflected in the amount of coverage purchased.

Business Interruption/Extra Expense coverage is also vital to a hospitality business' survival. Business Interruption provides funds to sustain a business while its operations are suspended because the insured property is damaged by a covered peril. Benefits are usually estimated by calculating a business' pre-tax net profit that would have been earned and the normal operating expenses and payroll that continue during the period of restoration.

The period of restoration generally begins on the date of the covered loss and ends on the date when the property reasonably should be repaired or when the business is resumed at a new permanent location. When estimating the amount of business interruption coverage to purchase, hospitality businesses should consider all income generating portions of a business: rooms, food and beverage, sundries, retail, conferences, entertainment, spa, gambling and gaming. Extra Expense benefits cover expenses incurred in mitigating damage to a business, such as expenses incurred setting up operations at a temporary location during the period of restoration.

Benefits that protect a business from loss caused by damage to non-business property

Hurricane damage is wide sweeping and will affect cities and counties, not just one business at a time. Even if a business survives a storm unscathed, it will likely be affected by damage to other businesses and public works. The following coverages should not be overlooked:

- Spoilage insures against loss to perishable stock caused by a change in temperature or humidity that results from mechanical breakdown, contamination or power outage for both on-premises and off-premises power sources.
- Utility Services insures against property damage resulting from an interruption of services by a facility that provides power, water or communications.
- Civil Authority provides business income benefits when a civil authority prohibits access to the insured property due to direct physical loss of or damage to other property.
- Utility Services–Time Element extends business income and extra expense insurance to protect against losses caused by interruption of services from a specified utility that provides a business with water, power or communications.
- Contingent Business Income or Dependant Properties provides lost profits and extra expenses resulting from an interruption of business at the premises of a customer or supplier or to property on which the insured company depends to attract customers.

Standard commercial policies do not cover flood

Not only must businesses consider the financial risks to property and operations, they must also contemplate the perils against which they must insure. Flood is not covered by standard commercial policies, even though it is a frequent and expected cause of loss. Flood insurance is essential for businesses in hurricane-prone areas, and coverage must be purchased separately from the National Flood Insurance Program or a private insurer.

Price the premiums and deductibles —What can a business afford?

Many businesses try to save money by increasing their deductibles, but this decision should not be taken lightly. Though hurricane and tornado wind damage is covered under a standard commercial policy, it's usually subject to a separate deductible. The deductible is often a percentage of the insured value, ranging from 2 to 20%. A policy with a 2% deductible generally costs significantly more than a policy with a 10% deductible, but the difference in premium reflects an appreciable risk. A 2% deductible for a building insured to $1,000,000, is $20,000; a 10% deductible is $100,000. Businesses that can't finance a large deductible should consider deductible buy-down insurance, which provides benefits to pay a deductible if a covered loss occurs.

Similarly, a business may choose to reduce its premium by insuring its property at less than full replacement cost value without understanding the consequences of a coinsurance provision. Co-insurance provisions usually provide that if property is not insured to a certain percentage of its replacement cost value, benefits can be prorated to the percentage of the amount of insurance purchased. For example, if $100,000 worth of insurance was purchased for a structure that had a replacement cost of $200,000 and there was a $50,000 loss, the insurer may pay only $25,000 (less the deductible), because only 50% of the replacement value insurance was purchased.

Hospitality businesses thrive on the Atlantic and Gulf Coasts, but success comes with an unavoidable risk of hurricane loss. Sufficient insurance is the best way to confront that risk. It brings peace of mind for business owners, investors, employees and customers with knowledge that they are protected from the financial calamity that comes with a severe storm and that the business will have the opportunity to prosper in the years to come. ✧

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