Introduction to Commercial Property Underwriting

1

COMMERCIAL PROPERTY LOSS EXPOSURES

Commercial property loss exposures can be identified in terms of types of property, causes of loss, and financial consequences.

A business that sustains major damage to its building experiences consequences that extend beyond the building itself. For example, owners of a retail store damaged by fire would incur the costs of rebuilding the damaged structure, as well as expenses related to the loss of the building's contents, cleanup costs, fire department charges, and income lost while the store is closed. Additional expenditures may be required to reestablish the business.

All of these considerations relate to components of a property loss exposure. Insurance professionals often identify property loss exposures in terms of these three elements:

- The types of property that might be exposed to loss, damage, or destruction
- The causes of loss that might lead to loss, damage, or destruction of property
- The financial consequences of a property loss

For example, an insurance professional might speak of a building exposure (type of property), a windstorm exposure (cause of loss), or a loss of business income exposure (financial consequence). Similarly, a property loss exposure could be identified more specifically in terms of two or even all three of these elements, such as a building fire exposure or loss of business income resulting from windstorm damage to a building and its contents. See the exhibit "Note to Underwriter: Commercial Property Loss Exposures."

Note to Underwriter: Commercial Property Loss Exposures

The many forms of property and the limitless ways in which it can be destroyed or its value severely diminished give rise to more types of property exposures than any one source could cover. This material presents an approach to analyzing property exposures and suggests specific and general ways in which an underwriter can evaluate and provide coverage for commercial property submissions.

[OV08300]

Types of Property

Property is any item with value. Individuals, families, and organizations own and use property, depend on it as a source of income or services, and rely on its value. Property can decline in value—or even become worthless—if it is lost, damaged, or destroyed.

Any item of property can be classified as either real property or personal property. It is important for a business owner to consider all property loss exposures that could affect the business, even if some of them (such as land) typically are uninsurable.

Real property is tangible property consisting of land, all structures permanently attached to the land, and whatever is growing on the land. Examples of real property, in addition to land, are buildings, driveways, sidewalks, underground piping, and radio transmission towers. All property that is not real property is personal property. Examples of personal property include vehicles, merchandise, furniture, tools, and clothing.

For insurance purposes, it is useful to categorize real and personal property into these classifications:

- Buildings
- Contents
- Property in transit
- Property in the possession of others
- Floating property

Buildings

A building consists of more than walls and a roof. Most buildings also include plumbing, wiring, and heating and air conditioning equipment. A high-rise building usually has elevators and may have specially designed platforms, hoists, and tracks used by window washers. Such equipment is also considered part of the building. Items permanently attached to the structure, such as built-in appliances, also are considered part of the building.

Contents

Contents
Personal property that is usually contained in a building or other structure.

The **contents** of a commercial building might include these items:

- Furniture, such as the desks in an office
- Machinery and equipment, such as cash registers
- Stock, such as raw materials and completed products in inventory

Although most insurance policies use the term "personal property" to refer to the contents of a building, many insurance practitioners and policyholders use the term "contents" as a matter of convenience and common practice.

Property insurance policies typically refer to personal property, rather than contents, because the property often is covered even when it is not literally contained in the building. Commercial property policies generally use the term "business personal property."

Property in Transit

Most businesses ship property (such as merchandise) to others or receive property (such as raw materials or supplies) from others. Property in transit may be transported by truck, railcar, airplane, watercraft, or even by bicycle or on foot. A shipment may be sent to a client's office a few blocks away, to a buyer on the other side of the world, or anywhere in between. Property in transit may be transported on the owner's own vehicles or by a transportation company. The property may be in transit for a few minutes or for several months. Because of all these variables, many insurance policies covering buildings and contents exclude property in transit. A firm that wishes to insure its property in transit must usually purchase separate cargo insurance.

Property in the Possession of Others

In many situations, an organization may place its property in the temporary possession of others for processing, cleaning, repair, adjustment, storage, exhibition, or sale. Because the probability of loss at the temporary location could differ greatly from the probability of loss at the owner's location, building and contents insurance policies usually provide only a nominal amount of insurance for property at other locations.

Like property in transit, property in the possession of others can be insured for its full value under specialized policies designed for that purpose.

Floating Property

Many businesses own property that normally is situated at ever-changing work sites or in transit between work sites. Examples of this kind of property include a wedding photographer's cameras and a building contractor's tools and mobile equipment. Such property is often referred to as "floating property" because it does not remain at a single location for a sustained period. Insurance for such property is available under specialized inland marine policies called "floaters." See the exhibit "Perils and Hazards."

Causes of Loss to Property

The potential causes of loss to property are another important aspect of property loss exposures. A cause of loss adversely affects property and leaves it in an altered state. For example, a fire can reduce a building to a heap of rubble. Vandalism can damage a building or its contents. Some causes of loss do not alter the property itself but do affect a person's ability to possess or use the