Commercial Property Insurance, Part I

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OVERVIEW OF COMMERCIAL PROPERTY INSURANCE

Almost all businesses, including not-for-profit and governmental organizations, face potentially devastating losses associated with commercial property ownership. Purchase of a commercial package policy's commercial property coverage is one method businesses may use to transfer the risks associated with such potential losses.

Commercial property loss exposures may be analyzed according to three components:

- Types of property
- Causes of loss to property
- Financial consequences of property losses

The commercial property coverage part is a common example of insurance policy provisions that cover commercial property loss exposures.

Commercial Property Loss Exposures

The three components used to analyze property loss exposures allow for identification of the exposures in specific terms. For example, they may refer to a building exposure (type of property), a windstorm exposure (cause of loss), or a loss of business income exposure (financial consequence). Similarly, they could identify a property loss exposure in terms of two or even all three of these elements, such as a building fire exposure or loss of business income resulting from breakdown of a production machine.

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**.

Real property (realty)
Tangible property consisting of land, all structures permanently attached to the land, and whatever is growing on the land.

Personal property
All tangible or intangible property that is not real property.

Examples of real property, in addition to land, are buildings, driveways, sidewalks, underground piping, and radio transmission towers. Property that is permanently attached to a structure, such as built-in appliances or paneling, is also generally considered part of the structure. For example, most buildings also include plumbing, wiring, and heating and air conditioning equipment. Similarly, a high-rise building usually has elevators and may have specially designed platforms, hoists, and tracks used by window washers. Such equipment is considered part of the building.

All property that is not real property is personal property. Examples of personal property include vehicles, merchandise, furniture, tools, clothing, and oil while being transported through an underground pipeline. For insurance purposes, personal property falls into these classifications:

- Contents—Property insurance policies typically use the term "personal property" to refer to the contents of a building (for example, office furniture, machinery and equipment, and stock such as completed products in inventory), rather than "contents," because the property often is covered even when it is not literally contained in the building. Policies generally use the term "business personal property" to refer to the contents of a commercial building. Contents also include personal property of others that is in the insured's care, custody, or control; this property is covered by the Personal Property of Others provision in commercial property coverage forms.
- Property in transit—Most businesses ship property to others (such as merchandise) or receive property from others (such as raw materials or supplies). Property in transit can be transported by a variety of means, for any length of time, and over various distances on the owner's own vehicles or by a transportation company. A commercial property policy may provide some coverage for property in transit, but it is often inadequate for insureds with significant transit exposures. A firm that needs broader coverage for property in transit can 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, repairing, adjusting, storing, exhibiting, or selling. 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 does not remain at a fixed work site or that is in transit between work sites (for example, a wedding photographer's cameras and a building contractor's tools and mobile equipment). Such property is often referred to as "floating" property. Insurance for floating property is available under specialized inland marine policies called "floaters."

Causes of Loss to Property

The potential causes of loss to property are another important aspect of property loss exposures. A cause of loss (for example, fire or vandalism) adversely affects property and leaves it in an altered state. Some causes of loss do not alter the property itself but do affect a person's ability to possess or use the property. For example, property lost or stolen may still be used, but not by its rightful owner.

Buildings and personal property are subject to many potential causes of loss. For most insureds, fire is the cause of loss that poses the greatest risk of a large or even total property loss. Windstorms, such as hurricanes and tornadoes; flood; earthquake; terrorism; and war also pose potentially catastrophic exposures for insurers and insureds.

Financial Consequences of Property Losses

Financial consequences are the third and final important aspect of property loss exposures. The adverse financial consequences of a property loss may include a reduction in the value of the property, lost income, and/or extra expenses.

When a property loss occurs, the property's value is reduced. This reduction in value can be measured in different ways. Property that must be replaced has no remaining worth, unless some salvageable items can be sold. If the property can be repaired or restored, the reduction in value can be measured by the cost of the repair or restoration. For example, if a fence worth $7,000 is damaged by a falling tree and the fence owner has to pay $2,000 to have the damage repaired, the fence owner has incurred a partial loss that reduces the value of the fence by $2,000.

A business may lose income as a result of a property loss. When property is damaged, income might be lost because the property cannot be used until it is repaired, restored, or replaced. For example, when a business suffers a serious fire, it might have to close until repairs to the building are made and personal property is replaced. The resulting loss of income occurs over time. As another example, the owner of a rental property faces rental income loss if the property is damaged and temporarily unavailable for rent. The owner would probably continue to incur some expenses, such as mortgage payments and taxes, but would not receive the rent that helped pay those expenses.

For a business to determine the extent of a property loss exposure, it must consider the extra expenses that the loss of the property would require. When property is damaged, the property itself declines in value, and the owner or other affected party suffers a corresponding loss. In addition, the owner or other user of that property might incur extra expenses in acquiring a temporary substitute or in temporarily maintaining the damaged property in a usable condition. For example, when a store's premises are damaged, the owners might have to rent temporary space at considerably greater expense than their normal rent.