LEHIGH VALLEY BUSINESS

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Reducing Commercial Property Insurance Costs

By Brian Heun

The commercial property insurance market is experiencing one of its most challenging times in history. Rates have risen for 20 consecutive quarters. Business owners can expect rate increases of 8% on average with some older properties or coastal properties increasing by up to 25%.

Brian Heun

A "perfect storm" has hit the property insurance market:

There has been an increase in catastrophic weather and natural disasters.

Flood prone areas - Urban development has increased the size and frequency of flood hazards. New construction removes vegetation and soil. Grading the land surface and constructing drainage networks increases runoff to streams from rainfall and snowmelt. Roads and buildings constructed in flood-prone areas are exposed to increased flood hazards, including inundation and erosion. FEMA cannot update flood maps quickly enough.

Unprofitability - Insurance companies, especially re-insurers, have not been profitable. Low interest rates have not provided proper investment income, although this is starting to change with the advent of Federal Reserve consecutive rate hikes.

Re-Insurance Rates - Losses in the Ukraine-Russia conflict coupled with catastrophic weather has put tremendous pressure on re-insurance renewals. Property catastrophe reinsurance rates for loss-hit U.S. accounts saw 45% increases with some catastrophic prone accounts witnessing 100% increases on January 1 renewals.

Capacity - A pull back from insurers is not just occurring on catastrophy prone accounts. We can attest to fewer and fewer insurers wanting to take risk. Accounts with poor loss history, older buildings or frame construction are experiencing the most pressure. In the past we saw capital in the form of new entrants in the market. However, that hasn't been the case recently, especially in the re-insurance market.

Valuation / Inflation - 40-year record high inflation; supply chain disruption; climate change; rising material costs and labor shortages are affecting reported property values. As a result, many businesses find themselves either underinsured or with large gaps in their property insurance programs. This is evidenced in a recent study of property appraisals by Kroll, which revealed that 68% of buildings valued from 2020 to 2021 were underinsured by 25% or more. 19% were underinsured by 100%. In total, close to 90% of the appraised buildings were undervalued. Insurance underwriters are running valuation reports on all submitted properties and adjusting values before quoting. In 2023 most carriers have begun adjusting rates to account for inflation, with some carriers offering scheduled limits rather than blanket limits.

Which strategies can you deploy to lower or keep property insurance costs static?

Loss Limit Approach - Larger spread-out property portfolios can insure to a limit of the probable maximum loss rather than an actual total property value. As an example, a manufacturer may have 10 locations at varying values totaling $100 million, while the largest location may be valued at $30 Million. Because no single storm, earthquake, or fire is likely to destroy any two properties in one occurrence, you could reasonably purchase a policy with a loss limit of $30 Million. Caveat: This would not be a good approach if your locations are all coastal or located in the same vicinity, as a large storm or event could "take out" multiple locations.

Reporting Values and Improvements and Betterments - Take adequate time to document proper values and any improvements performed to your building. Remember, the value is not your property's *market* value. Instead, use the *replacement* cost of the building, taking into consideration material and labor costs, code upgrades required at the time of the loss and market conditions that might influence the availability of contractors or materials. Additionally, be sure you receive credit for all protective features on your properties. These can include sprinkler systems, central station smoke and burglar alarms, recently inspected fire extinguishers, multiple means of egress and more. Similarly, if you've recently upgraded a building, replaced a roof, or obtained an updated appraisal, let your insurance broker know.

Business Continuity Plan - When was the last time you have updated your Business Continuity Plan? Do you even have a formal plan? Do you have generators on site? Have you built a relationship with or hired a disaster recovery company to aid when large losses occur? Some companies for a small fee will provide power at the ready, workstations, server back-ups and alternative work space.

When was the last time you've analyzed your business interruption limits? Are they adequate? The insurance market calls it business income coverage but it's really loss of profits plus extra continuing expenses. I recently analyzed a company's business interruption limit only to find they were over insured by 60% during the past few years due to revenue declines from the pandemic.

Avoid Accepting Co-insurance or Reductions in Coverage - As property rates go higher and the economy falters it may be easy to cut coverages to reduce costs. Resist the urge. Co-insurance is your insurance company's way of encouraging you to insure your buildings and contents and business income limits to accurate replacement value. Insurers will apply a coinsurance penalty, essentially reducing the amount they will pay for a claim if the coinsurance minimum is not met. In cases in which the property is underinsured, the insurer will reduce coverage proportionally, even if the loss is less than the limits of insurance. The carrier gets to make this determination after a loss. Make sure your broker is negotiating "agreed value" on your behalf.

Similarly, don't accept protective safeguard warranties, water exclusions, margin clauses, or monthly limits of indemnity. Reducing costs shouldn't equate to reducing value.

Increase Your Deductible - This might be common sense but ask for higher deductible options if you can afford to take on more risk. You can also raise your deductible on problem areas of your portfolio, such as wind/hail. As an example, it may be a wise choice to have an increased deductible on wind/hail if you had prior losses.

Improve Risk Profile - Have you ever had a thermal infrared scan on your buildings? Some carriers will perform the service for free. A scan can detect "hot spots" which could mean electrical issues and stop fires before occurring. "Cold spots" could indicate wetness or leaks. Some insurance companies offer water sensors which detect leaks (and alert your smart phone) before they occur. Depending on your insurance carrier, hardwired smoke detectors, central station alarms, sprinkler systems, electrical improvements, new roof and more may generate discounts of up to 25%. Of course, an ROI calculation needs to be performed to discover if the costs = longer term benefits. Some carriers refuse to quote buildings with roofs older than 20 years.

Parametric Insurance - covers the probability of a predefined event happening instead of indemnifying actual loss incurred. Possible events are earthquake, flood, wind speed, precipitation, power outage and crop yield. A pre-agreed pay-out may occur if the parameter is reached or exceeded, regardless of actual physical loss sustained.

For example, $10 million if a category 5 storm occurs in a defined area, or $50,000 for every millimeter of cumulative rainfall above a certain threshold.

The threshold is usually set to align with a client's own business continuity plan and risk tolerance.

Parametric insurance is not designed to replace but to complement traditional insurance. It can fill protection gaps left by indemnity insurance like higher deductibles, excluded perils, dependent property coverage concerns or scarce capacity.

Require Renter's Insurance - For residential rental property owners - you can require a clause in the lease requiring the tenant to carry renter's insurance.

Bottom Line - As capacity continues to shrink and rates increase, business owners must look at other avenues to protect their hard assets and balance sheets. Once you reach a certain size and level of complexity, it's not about rate shopping to get the best insurance for the dollars spent. By putting in a little extra time, resources and effort you should yield a better result in the long run.

Your trusted broker who has the benefit of expertise and experience can be your valued ally.

Brian Heun is the Sales and Relationship Manager and a Partner at KMRD Partners, Inc., a nationally recognized risk and human capital management consulting and insurance brokerage firm located in the Philadelphia region serving clients worldwide. Brian can be contacted at bheun@kmrdpartners.com