

*All About
Hotel Insurance*

**A Comprehensive Guide
to
Insuring Your Hotels**

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FORWARD

Most people think that all insurance policies act the same way. They believe that the only difference from one policy to the next is the price and the limits purchased. This could not be further from the truth. The reality is that there are literally hundreds of different ways to insure the exact same property - each having their own set of coverages and pricing factors. Which is best all depends on the needs of the insured and the specific property being covered.

The following pages contain explanations on how the coverages that most pertain to hotel/property management companies work. It has been my experience that hotel/property management company owners have never really had what they are actually buying explained to them, thus most are not properly insured. The owners are usually under the assumption that all policies basically cover the same thing. That the pricing is the only real difference between policies. I hope to demonstrate to you that there is a lot more to a policy than just the building, contents and liability limits. Of course pricing is of the utmost importance but in my opinion the best price in the world isn't any good if you find out that you aren't covered in the event of a loss. A properly constructed insurance policy can accomplish both excellent pricing as well as superior coverage. All it takes is making sure you purchase adequate amounts of the coverages you need, and not buying the coverages you don't need.

The following document contains a lot of information. I will be the first to admit that learning how an insurance policy works isn't exactly how most people would like to spend their free time. Taking this into consideration, I have written a coverage summary at the end of each section. This summary will give you the highlights of what things need to be considered when customizing your policy. If you do decide to take the time to read through the whole document in detail, chances are you will know more about your insurance policy than your current agent. I recommend that you at least read pages 6,7,18 and 23 and then read about whatever you think may pertain to you.

Please feel free to keep this booklet for future reference. If you would like me to provide a full insurance analysis for you including a professional property valuation, coverage needs analysis as well as a quote I would be more than happy to do so - after all I am in the insurance sales business. This is not the reason I have written this booklet. The main reason is because I believe that the educated customer is the best customer. I only ask that if you do have a need in the future to keep me in mind.

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PROPERTY COVERAGE SECTION

Deductible & Co-Insurance

Before I can begin to demonstrate how your insurance policy works, I first must explain the concepts of deductible and co-insurance. These two items pertain to almost every aspect of your insurance policy and the proper way insure your business. Following is a basic explanation of what a deductible and co-insurance are and how they work.

Deductible

The deductible on a policy is the amount of a loss that you as the insured agree to retain, or self insure. For example, if you have a \$2,500 deductible and a \$15,000 loss, the insurance company would pay \$12,500 of that loss because you pay the first \$2,500 of the loss. The larger the deductible, the lower your premium because you are self insuring for a greater amount. Generally, the deductible only applies to the property coverages on your policy. Occasionally my customers also decide to take a deductible on the liability coverages as well, but usually no deductible applies to liability coverage.

Co-Insurance

Co-insurance is one of the most widely misunderstood concepts in insurance. Co-Insurance is simply the percentage of "total insurable value" that a risk must be insured for. The higher the co-insurance percentage, the lower the rate per \$1,000 of coverage the insurance company will charge. This is kind of the price club mentality in the insurance industry - the more insurance that you agree to buy, the lower the price per thousand will be. The big trade off with selecting a high co-insurance percentage (thus a low price per \$1,000 rate) is that you agree to always maintain a limit of at least the co-insurance percentage that was agreed upon. If you fail to maintain the minimum level, the co-insurance penalty will apply.

For example, let's assume that a building has a total replacement cost of \$10,000,000. If you select a co-insurance level of 80% you must maintain at least \$8,000,000 of insurance on that building. If you decide you want to take advantage of the lower price per \$1,000 offered by selecting a 90% co-insurance level, then you must buy at least \$9,000,000 of coverage on that building. In the 90% co-insurance scenario, the price per thousand (rate) will be lower but the total premium would actually be more because you have to buy \$1,000,000 more insurance to maintain the 90% co-insurance level. The co-insurance penalty comes into play when you do not maintain the proper levels of insurance. In our \$10,000,000 building example, if you selected a 90% co-insurance but only purchased \$4,500,000 of building insurance – you would have a huge problem in the event of a loss. The co-insurance penalty provision states that if you did not maintain adequate levels of insurance, the insurance company only has to pay a portion of the loss. The formula that determines how much the insurance company has to pay on a loss is as follows:

How much you did insure for divided by how much you should have insured it for times the loss. More commonly expressed as $DID \div SHOULD \times LOSS$

So in the above scenario, the company would only have to pay 50% of any loss. If you were to have a \$1,000,000 fire, the company would only pay you \$500,000. Here is the math –

\$4,500,000 (DID) divided by \$9,000,000 (SHOULD) times \$1,000,000 (LOSS) equals \$500,000.

As you can see, co-insurance is an extremely important consideration when constructing a proper insurance policy. Co-insurance will apply to many different coverages that pertain to your business. I will go over these in more detail later in the document.

Types of Policies

There are a few different policy types designed to insure commercial property. The most common two types are the Business Owners Policy and the Commercial Package Policy. There are pros and cons to each different type, so which one is better suited for you really depends on the size of your business. Here are the basic explanations of each type of policy.

Business Owners Policy (BOP)

The Business Owners Policy, more commonly known as a BOP, is a product that was developed in the 1980's primarily for small business owners. The way it works is it takes what would normally be a few different policies covering different aspects of your business and combines them into one policy. The advantage of this policy is the savings enabled by combining the policies. Because so many different coverages are all combined onto one policy, the insurance companies offer these coverages at a much lower rate than if they were to be purchased al la carte. The big disadvantage is that because all of the coverages are combined in a pre-set format, you can't pick and choose which coverages you want. More importantly you are limited to the amount you can buy on certain types of coverage.

This policy is great for its intended customer - the small business owner, as it generally gives you all of the coverage types that you need and at a great price. The problem is when the business starts to be a little on the larger size because many of the coverage limits offered will be inadequate to meet your needs. This could result in you having to pay out hundreds of thousands of dollars in the event of a claim because your limits weren't high enough. This policy is not very customizable to suit the needs of larger properties. I would only recommend a BOP to hotels with 40 units or less or other smaller commercial properties. For anything larger than that you should really be on a Commercial Package Policy.

Commercial Package Policy (CPP)

The way a Commercial Package Policy works is that a whole bunch of individual policies and policy forms are presented and billed in a packaged format. This gives the appearance of one policy when in actuality it is still many individual policies and forms. Some of the different policies and forms may include property, liability, equipment breakdown coverage, commercial auto, loss of business income coverage and many more. The biggest disadvantage of this type of policy is that although it may appear to be only one policy, it is in actuality still many policies - thus you don't get the packaged coverage discount offered on the BOP. This is somewhat offset by other discounts offered that are not available on the BOP, but generally speaking a BOP will usually be less expensive than a CPP on a dollar for dollar basis. On the other hand, a BOP forces you to buy many coverages that you do not need and does not allow you to buy increased limits for coverages that you do need.

The biggest advantage to a CPP is its ability to be highly customized. For a larger property, this is the only way to ensure that you are properly covered. You only purchase the coverages that you need and the amount needed for each individual coverage. Some examples of coverages that would need to be increased over the limits offered on a BOP would be demolition coverage, business income coverage, ordinance or law coverage and equipment breakdown coverage. Many banks require limits higher than those offered on a BOP - so many times a CPP is the only choice. I recommend this type of policy for hotels with 40 or more units and medium to large commercial properties. On these larger accounts a BOP has too many gaps in coverage.

Different methods of valuation for a policy

Replacement Cost

Replacement cost is defined as what it would cost to replace your property with like kind and quality. This is the “total insurable value” that I mentioned in the co-insurance section. In the event of a loss, a replacement cost policy will pay what it costs to replace property at today’s prices, as opposed to what you actually paid for them. It also does not factor in any depreciation. You do have to be mindful of the co-insurance provision on a replacement cost policy. Inflation may put you at risk of being subjected to the co-insurance penalty if you do not re-assess your property limits on a regular basis. I recommend that you assess all of your limits with your agent at least once a year. As long as you and your agent review your limits on a regular basis, a replacement cost policy is definitely the type of policy I would recommend. The benefits far outweigh the liabilities.

Actual Cash Value

Actual Cash Value is defined as Replacement Cost less depreciation. What this means is that in the event of a loss, the company will only replace the depreciated value of the damaged item. The main advantage of this type of policy is that it enables you to purchase lower limits without worrying so much about the co-insurance penalty. The obvious disadvantage is that the insurance company will only pay a portion of what it will cost to replace an item. I would only recommend this type of policy to the most cost sensitive customers who want to get their insurance premium as low as possible.

Here is an example of how a replacement cost policy and an actual cash value policy would respond to a loss:

Let’s assume that you purchased a \$10,000 air conditioning unit 6 years ago and it was destroyed by a lighting strike. A replacement cost policy will pay the actual replacement cost, even if that cost is more now than the \$10,000 that you originally paid for the unit. On an actual cash value policy, the company will only pay the depreciated value. If you were depreciating the unit over 10 years, the depreciated value would only be \$4,000 – that is what the company would pay.

Functional Replacement Cost

This type of policy differs from a traditional replacement cost policy in that it is designed to give you functional replacement of your property instead of replacing it with exact like kind and quality. An example of when this type of policy might be applicable is with converted use properties, such as if an old estate mansion is converted to be used as a hotel or restaurant. Usually it would be very difficult or even impossible to replace this type of structure with like kind and quality. To purchase replacement cost coverage on such a structure would be prohibitively expensive and many times it makes more sense to re-build a more purpose built structure. A high-end purpose built hotel/restaurant would be much less expensive to build than a converted 100 year old mansion, so sometimes an owner may elect to only insure for what a functional replacement would cost. Another time when this type of policy may be useful is if you are only using part of the building. If the building were to be destroyed, it would not make sense to re-build the part of the building that you were not using. If you choose to use this type of policy, a functional replacement cost must be agreed upon by both the insurance company and the insured at the policy inception.

Market Value

This type of policy does not take replacement cost into consideration whatsoever. The amount of insurance needed is determined by the market value of the property. This type of policy is useful if an insured has no intention of re-building in the event of a loss. Not many companies offer this type of policy because it inherently increases some morale risks, especially if the owner has no real long term interest in the property. It usually takes some convincing for the company to give this type of policy.

Agreed Value

The agreed value clause is used to eliminate any possibility of the co-insurance penalty. This clause is added when the insurance company agrees that the amount of insurance being purchased is adequate, so they waive any right to the co-insurance penalty. A "Statement of Values" must be filled out, signed by the owner and submitted to the insurance company every year. Once the "Statement of Values" expires, co-insurance comes back into play, thus a new "Statement of Values" needs to be re-submitted annually to maintain the agreed value clause. The agreed value clause usually is triggered at the request of the mortgage company to protect their assets.

Causes of Loss

This section helps to answer the age old question - "Am I covered?". The answer all depends on what type of policy you have. There are three different forms available that determine what is covered and what is not. You can also buy additional coverage for certain items not listed below, which I will go over later. The three different form choices you have are described below.

Basic Form

This form covers the following causes of loss:

- 1.) Fire
- 2.) Lightning
- 3.) Explosion
- 4.) Windstorm or Hail
- 5.) Smoke
- 6.) Damage from aircraft or vehicles
- 7.) Riot or Civil Commotion
- 8.) Vandalism
- 9.) Sprinkler leakage or discharge
- 10.) Sinkhole Collapse
- 11.) Volcanic Action

If it is not listed above, it is not covered on the basic form.

Broad Form

This form contains the 11 causes of loss in the Basic Form, but add three more:

- 1.) Falling Objects
- 2.) Weight of Snow, Ice or Sleet
- 3.) Water Damage – caused by accidental escape from plumbing, HVAC, appliances or other systems. This does not include ground water.

Special Form

This form is the most comprehensive of the three types of causes of loss forms. The Basic & Broad forms operate on a “named peril” basis, meaning that the insured has to demonstrate that the loss was caused by one of the named perils in order for it to be covered.

The Special Form operates in the exact opposite manor. The Special Form contains a list of exclusions. If the cause of loss isn't specifically excluded, then you are covered. This is the only form that I would ever recommend. Following is a list of the exclusions. Please note that many of these exclusions can be bought back – I will cover the ones most applicable too you later in this document.

Exclusions:

- 1.) Ordinance or Law
- 2.) Earth movement
- 3.) Governmental Action
- 4.) Nuclear Hazard
- 5.) Utility Services
- 6.) War & Military Action
- 7.) Water, unless caused by accidental escape from your systems
- 8.) Artificially generated electric current
- 9.) Delay, loss of use or loss of market
- 10.) Smoke, vapor or gas from agricultural smudging or industrial operations.
- 10.) Traditional “open causes of loss” exclusions:
 - A. Wear & Tear
 - B. Rust, corrosion, fungus, decay, deterioration or inherent vice
 - C. Smog
 - D. Settling, cracking. Shrinking or expansion
 - E. Nesting or infestation, or discharge or release of waste or secretions by insects, rodents, birds or other animals
 - F. Mechanical breakdown
 - G. Loss to personal property by dampness, dryness, changes or extremes of temperature, marring or scratching.
- 11.) Steam boiler and machinery risks
- 12.) Seepage or leakage of water for 14 days or more
- 13.) Freezing of plumbing, heating or air conditioning equipment, unless you did your best to maintain heat in the building or you drained the equipment and shut off properly.
- 14.) Dishonest or criminal acts
- 15.) Voluntary parting with any property
- 16.) Rain, snow, ice or sleet to personal property in open
- 17.) Collapse
- 18.) Pollution
- 19.) Neglect of an insured to preserve property from further damage at and after the time of loss

What you need to insure

Now we are getting down to the nitty gritty of how to properly construct your policy. As the saying goes, the devil is in the details, and here is where this comes into play. If the following items are not addressed properly you may run into co-insurance penalty problems, or worse yet - no coverage at all in the event of a loss. The following list contains the most common types of property that need to be insured for your type of business.

Building

This only applies if you actually own the building that you are located in or if you are required by your lease to purchase coverage on the building. Before you can determine the proper amount to insure your building for, you must first decide which valuation method you will be using (Replacement Cost, Actual Cash Value, Functional Replacement Cost, Market Value or Agreed Value) then you must choose a co-insurance level. Remember, the higher the co-insurance level you choose the lower the rate per thousand dollars of coverage, but you must buy higher limits in order to satisfy the co-insurance requirement. Next the actual replacement cost needs to be determined. Most companies use an independent valuation company known as Marshall & Swift to determine what the 100% replacement value is. The number that they come up with is the baseline for determining everything else. If Marshall & Swift determines that the replacement cost is \$1,000,000 and you went with a 80% co-insurance level, then you must be insured for at least \$800,000 - otherwise the co-insurance penalty will come into play. If the unfortunate situation happens that you have a co-insurance penalty on a loss and you disagree with Marshall & Swifts numbers, the burden of proof would be on you to prove their numbers were inaccurate. Obviously it is much smarter to adjust your limits and/or valuation method than it is to take your chances with a co-insurance penalty. You should also speak with an insurance agent to determine what the proper values are before a loss actually happens. It really amazes me how many businesses are grossly underinsured and have no idea that they are.

Business Personal Property (Contents)

This is very similar to the building coverage except that it is your "stuff" in and around the building as opposed to the building itself. A good rule of thumb is that if it is permanently attached to the building then it is considered part of the building, otherwise it is considered contents. Many electronic equipment devices are not covered as contents and need to be insured in a different section of your insurance policy - more on that later. Interestingly enough though, for hotels - anything that pertains to the maintenance of the building is considered part of the building. This includes the cleaning carts, washers & dryers, ect.

Business Income & Extra expense

This is one of the most important, and most overlooked coverages needed by hotel/property management companies. Simply put, business income pays for lost profits and continuing expenses in the event of a covered loss. There are a few different ways to write this type of coverage. The way I recommend for hotel management companies is the co-insurance method. As the name implies, with this method you select which co-insurance amount you would like (the options are 50%, 60%, 70%, 80%, 90%, 100% or 125%) then you select a limit that will satisfy the selected co-insurance limit. To determine the proper limit you take your annual revenues then subtract what expenses would go away if the property was closed due to a loss. You then multiply that number by the co-insurance percentage that you chose. The advantage to this method is that there is no time limit on how long business income will pay for. This is important because it often will take longer than a year to get a property back up and running after a large loss. As long as you have an adequate limit, the policy will pay for your lost profits plus ongoing expenses for as long as it takes to re-open.

Business Income Coverage operates differently on a BOP policy. In this case you don't have to worry about co-insurance because the limit is "actual loss sustained", meaning you can never run out of limit. Unfortunately a BOP has a time limitation instead of a monetary limitation. Usually a BOP will only pay the Business Income coverage for 12 months from the time of loss. This is a great feature for the smaller motel because generally 12 months to get back up and running is more than adequate. For a mid sized to larger hotel, the chances of being back in business within 12 months of a large loss are very slim. This could pose a serious problem financially for the larger hotel. This is one of the main reasons that I would not recommend a BOP for larger properties.

Equipment Breakdown Coverage

Of all the losses experienced by hotels and property management companies, probably half of them are equipment breakdown type losses. These are losses due to "artificially generated electric current", black and or brown outs and any other electric disturbance that originated more than 100 feet from your property. These types of losses may also be attributed to boiler explosion or "sudden & accidental" mechanical failure. Unfortunately the standard insurance policy excludes coverage for this type of loss. In order for this type of loss to be covered you need to purchase the "equipment breakdown endorsement". The way this endorsement works is that it removes most of the exclusions in the standard insurance policy for electricity based losses, pressurized vessel explosions and mechanical failure. This is the best way to make sure all of your "systems" such as HVAC, computers, alarms, pools, electronic equipment and many other systems are covered. I consider this an essential coverage for hotel and property management companies.

Ordinance or Law Coverage

In the event of a loss, the responsibility of the insurance company is to bring you back to where you were prior to the loss - no more and no less. Essentially they have to pay (less the deductible) to rebuild with like kind and quality. The problem here is that sometimes a municipality will make you re-build to a higher standard than were you were at prior to the loss, or sometimes the municipality may even make you demolish the undamaged portion of the building. According to the standard insurance policy, that isn't the insurance company's responsibility. The insurance company only agreed to make you whole again, not to give you an upgrade.

The way to get around this gap in coverage is to purchase "ordinance or law" coverage. This coverage will pay for any "upgrades" to the building required by ordinance, law and/or new zoning requirements - up to the limit selected. It will also pay for the undamaged portion of a building if its demolition is required due to ordinance or law as well as the increased demolition cost.

On a BOP, this coverage is limited to a pre-selected amount which usually cannot be increased to address the needs of a larger property. This could be a major problem. Lets say that you have a \$1,000,000 building insured on a BOP with a \$25,000 ordinance or law coverage limit. Most municipalities today require that an entire structure be demolished if over 50% of it is destroyed in a fire. If 55% of your building is destroyed in a fire, most likely your local municipality will require that the whole building be demolished. The standard insurance policy will only pay for the \$550,000 damaged portion of the building. The rest will come from the ordinance or law coverage. If you were insured on the above mentioned BOP, only \$25,000 will be paid on the balance and the remaining \$425,000 will come out of your pocket. You will also have to pay for the demolition of the undamaged portion of the building as your policy will only pay for the damaged portion. Obviously, this is a coverage that needs to be looked at very seriously.

Employee Dishonesty Coverage

Nobody likes to think that their own employees could possibly be taking advantage of them. The unfortunate reality is that embezzlement cases are reaching an all time high, and quite often the employees committing these crimes are some of the most trusted employees of the owner. The best protection against this is a solid auditing procedure, but for an added level of comfort you can purchase employee dishonesty coverage. This coverage is usually included (at a pre-set limit) on a BOP policy and commonly added to a package policy. The necessary limit usually depends on how sound your auditing practices are and how much money you usually have at risk.

Debris Removal

Debris Removal coverage pays for the cost to cart away the debris created in a covered loss. The limit for Debris removal is 25% of whatever the limit is for the property itself, plus \$10,000. It is very important to note that this cost comes out of your total property limit - it isn't in addition to it. If it costs \$200,000 to remove all of the debris from a loss to a \$1,000,000 building, you then only have \$800,000 (plus the extra \$10,000) left to re-build with. For this reason it is very important that you take the cost of debris removal into consideration when determining the amount of building limit you are purchasing. The Marshall & Swift valuation method takes debris removal into consideration, that is why their numbers usually seem to be a little on the high side. You also have to consider if your building has costly debris removal issues, such as asbestos or large quantities such as heavy materials like metal or stone that could drive up your debris removal cost. This could render your current limits inadequate and subject you to a co-insurance penalty.

Electronic Data Processing (EDP) Endorsement

The Electronic Data Processing, or EDP endorsement works very similarly to the Equipment Breakdown endorsement except that it doesn't cover as many items. This endorsement is designed to cover all of your computer and telephone equipment, as well as related software. This is a redundant coverage and is not necessary if you already purchased the Equipment Breakdown endorsement. Because I recommend that you purchase the Equipment Breakdown endorsement, I don't recommend that you purchase the EDP endorsement.

Water Back-up Coverage

With the exception of plumbing leaks, burst pipes, seepage and accidental discharge from your systems, water damage is excluded on a standard insurance policy. This means that any water back-up from sewers and/or any flood water is not covered. You can buy a small amount of this coverage as an add on to a standard insurance policy, but usually not enough to provide adequate protection. You can better cover yourself by purchasing a flood policy or a "DIC" policy, but these policies are very expensive and are subject to large deductibles. The most cost effective way to protect yourself is to keep valuables out of harms way of ground and flood water. If you are in a flood zone I recommend that you purchase a flood policy. You can also purchase a DIC policy which covers a variety of things such as flood, earthquake, landslide and other similar hazards - but obviously will cost more than a stand alone flood policy.

Inland Marine Coverage

Inland Marine coverage, commonly known as a "floater" is used as a policy add on to cover a specific item - usually an item higher in value or importance. This coverage provides the best possible coverage you can get and includes many coverages that are excluded on the standard policy. This type of policy add on usually is written on an agreed value basis and requires some sort of appraisal before the coverage is added. In the event of a loss, in most cases you get the limit that you purchased with no depreciation factored in. If you have an extremely important item and want the best coverage possible on it, this is the way to do it.

Property Coverage Summary

When constructing the property section of your insurance policy, the following items need to be addressed:

1.) First you need to determine what deductible and co-insurance percentage you would like. Keep in mind that the higher the deductible is the more of the loss you will retain yourself but your premium will be lower. Likewise, if you choose a higher co-insurance percentage then your rate per thousand dollars of coverage will be lower, but you need to purchase higher limits to maintain that co-insurance percentage.

2.) You next need to determine if you should be on a Business Owners Policy or a Commercial Package Policy. A Business Owners Policy is better suited for the smaller commercial property or hotel because it offers great coverage for a very reasonable price. A Commercial Package Policy is better for the mid sized to larger property because the coverages offered on the Business Owners Policy are not adequate to meet the needs of larger properties. A Commercial Package Policy is also much more customizable, so you only buy the coverage you need, and only as much as you need, of each coverage.

3.) The next thing that needs to be considered is what property valuation method you would like. Your choices are Replacement Cost, Actual Cash Value, Functional Replacement Cost, Market Value and Agreed Value. Each method addresses different needs. Which one is best for you depends on your specific circumstances.

4.) You now have to determine which "causes of loss" form you would like. The choices are the Basic Form, the Broad Form and the Special Form. The price for each form goes up as more causes of loss are added, with the least expensive form being the Basic Form and the most expensive being the Special Form.

5.) Lastly you need to determine the limits on your policy - which are determined largely by the co-insurance percentage and valuation method you chose. You also need to decide which coverage endorsements or "add ons" you would like to purchase and the limit for each endorsement. Some of the endorsement "add ons" that pertain to hotel/property management companies are as follows:

- Business Income & Extra Expense*
- Equipment Breakdown coverage*
- Ordinance or Law coverage*
- Employee Dishonesty coverage*
- Electronic Data Processing coverage*
- Water Back-up coverage (Flood Policy or on a DIC Policy)*
- Inland Marine coverage - items that need to be specifically insured.*
- Earthquake (Stand alone coverage or on a DIC Policy)*

There are many other property coverages, endorsements and add ons available which you may or may not need depending on your specific situation. The above mentioned coverages are the ones that usually apply to hotel & property management companies.

LIABILITY COVERAGE SECTION

Liability coverage comes into play when you are legally liable to pay for damages. In this section of the insurance policy, the insurance company agrees to pay (up to the policy limit) anything you are legally obligated for from damages that you have caused, as well as any associated defense costs. Some of these damages may include damage to property, medical bills and "pain and suffering" caused by someone getting hurt on your property. Damage resulting from libel or slander, damage caused by a product you produced, liquor liability and contractual liability. Below I will discuss each aspect of the liability section of your policy.

Named Insured

The named insured is the company(s) and or individual(s) listed in the named insured section of your policy. There may be more than one named insured on a policy. Anyone who is a named insured on a policy is afforded coverage on the liability section of the policy. Many times a hotel/property management company actually has one corporation who operates the property and another corporation that owns the property. It is very important that both entities are listed as named insureds. If one of the corporations was inadvertently not listed as a named insured, and that corporation was named in a lawsuit, that corporation would not be covered.

Additional Insured

An Additional Insured is treated much the same way as a named insured. An entity is usually listed as an Additional Insured to protect their interest in a property. This extends the liability coverage of the policy to include the Additional Insured, but only to the extent of their interest in the property. Some common examples of this are listing a grantor of a franchise or a landlord as an additional insured to protect them in the event that they are named in a lawsuit pertaining to the covered location. Occasionally a bank or mortgage company will also require that they be listed as an additional insured. This is not to be confused with the "Loss Payee" clause. The "Additional Insured" clause is designed to protect them in the event that they are named in a lawsuit, whereas the "Loss Payee" clause protects their financial interest in a property.

Occurrence and Aggregate limits

The Occurrence limit is the most that the policy will pay for any one loss. The Aggregate is the most that the policy will pay out in any given policy year. For example, if a policy has a limit of \$1,000,000 per occurrence and a \$2,000,000 aggregate, then this policy will pay up to \$1,000,000 for any given lawsuit but it will never pay more than \$2,000,000 for all of the combined lawsuits in any given policy year.

Premises Liability

This coverage pertains to lawsuits arising from someone getting hurt at the insured location. This covers the common "slip and fall" lawsuits. It does not cover damage to other people's property that occurred on your premises. That is a different thing altogether and is subject to a much lower limit, if it is even covered at all.

Personal Liability

Personal Liability is usually triggered as a result of the words and/or actions of the owner(s), officers or employees of the business that results in a lawsuit. Basically, if someone was “wronged” by an owner or employee, this coverage would come into play.

Products & Completed Operations Liability

This coverage protects the insured from any damage caused by a product that they make or distribute. This coverage normally does not apply to hotels or property management companies because it is very rare that they actually “make” something. It does, however, become quite important to a restaurant because the food that is served is a “product”. This coverage is most commonly associated with manufacturers, but there are occasions when it will come into play with hotels and property management companies.

Liquor Legal Liability

This will protect the insured from any lawsuits arising from the sale of alcoholic beverages. It is sometimes referred to as “Dram Shop” coverage. Obviously this coverage is not needed if your business does not serve alcohol.

Contractual Liability

As the name implies, Contractual Liability arises when the insured is made liable due to a contractual obligation. This can take many forms, the most common being stipulations contained in a lease agreement. If a contract stipulates that the insured will be held liable in the event of a specific situation, even if the insured would normally not be held responsible, then the insurance company must pay that liability. Because of this, you should send any contract to your insurance agent for review before you sign it. You may inadvertently be putting your company on the hook for something you didn’t intend to.

Fire Legal liability

This normally only applies if you are renting a facility. This coverage pays for damage caused by you to a rented premises. It is typically subject to a lower limit than your other liability coverages. If for some reason you need a higher Fire Legal liability limit, it needs to be addressed with your agent.

Property of Others Coverage

As I mentioned earlier, this coverage is typically subject to a much lower limit than your other liability coverages. That is something to be considered if you routinely have high values of other peoples items in your care, custody or control. You can purchase higher limits, but it will need to be addressed with your agent.

Commercial Umbrella and Excess Liability policies

All of the liability coverages (and their limits) discussed on the preceding pages are known as the “underlying” coverages and limits. Typically there is a maximum underlying limit that you are able to purchase - commonly \$1,000,000 per occurrence and a \$2,000,000 aggregate. Most insureds require much higher limits than the ones offered on the underlying policy. There are two ways to accomplish this. You can purchase an Umbrella policy or Excess Liability policy - offered in million dollar increments of coverage over the underlying limits. An Umbrella policy will increase the limit over all of the underlying policies, whereas an Excess Liability policy will only increase the limit over a specifically named policy. For example, if you have a commercial auto policy, a BOP or CPP policy and a worker’s compensation policy - an Umbrella policy will increase the total limit over all three of your underlying policies. An Excess Liability policy will only increase the limit over whichever policy you choose. If you wanted the limit to be increased for all three underlying policies, you would need to purchase three Excess Liability policies - one for each of the underlying policies. In this case, obviously an Umbrella policy would make more sense.

Many times a bank or grantor of franchise will require certain liability limits. Choice Hotels requires that the franchisee maintain a minimum of \$5,000,000 per occurrence of liability coverage. Since the maximum you can usually purchase on a BOP or CPP is \$1,000,000 per occurrence, you will need to purchase a \$4,000,000 Umbrella or Excess Liability policy. The \$1,000,000 underlying coverage plus the \$4,000,000 of Umbrella or Excess Liability coverage will bring you to the \$5,000,000 of total coverage needed.

Commercial Auto Policy

Much like a BOP or CPP policy, there are two main components to a commercial auto policy - the liability section and the property section, more commonly referred to the physical damage section on an auto policy. The liability coverage will pay for damage caused by your vehicle to other peoples health or property, providing you were actually negligent. The physical damage section will pay damage sustained by your vehicle and is further broken down into two more coverages - comprehensive and collision coverage. The collision coverage will pay when your vehicle is in an accident while comprehensive applies to all damage sustained to your vehicle in anything other than an accident, including hitting a deer. A deductible usually applies to the physical damage coverage of an auto policy

A commercial auto policy can also provide “Hired & Non Owned Auto” coverage. Hired auto applies when you or your employees use their own personal vehicles for business on your behalf. Because the personal auto policy for your employee’s vehicles excludes business use, it is very important that you have this coverage. Non Owned auto usually applies to rented vehicles. You may purchase liability coverage, physical damage coverage, or both on the hired & non owned auto section of your policy.

Worker's Compensation

Most states require that all employers carry worker's compensation insurance for their employees. This policy will pay for medical expenses, lost wages and occasionally pain and suffering for injuries sustained by your employees while on the job. It is rated according to payroll and job classification.

Group Disability

This policy is also required by most states. It will pay for the lost wages of an employee for any illness or injury sustained by that employee while not on the job. This policy has very limited coverage for your employees. Enhanced disability policies are available, although not required, if you would like to offer your employees additional protection. Because pregnancy is technically defined as an illness when it comes to a disability policy, the premium for female employees is much higher than it is for male employees. Obviously the chances of a male employee putting in a disability claim due to pregnancy are extremely low, thus the premium for a male employee is much lower.

Employment Practices Liability (EPLI)

This policy is designed to cover the owners and officers of a corporation in the event of a lawsuit arising from discrimination or sexual harassment. This policy is not required by any states, but many franchisors are now requiring that their franchisees purchase this coverage. It is very reasonably priced given that discrimination and sexual harassment cases continue to grow in number.

Liability and other coverage summary

Liability can be broken down to many sub categories with their own separate limits. You must decide which coverages and limits best suit your needs. Some of the sub-categories include premises liability, personal liability, products and completed operations liability, liquor legal liability, contractual liability and fire legal liability. Most of these coverages have both a per occurrence limit and an annual aggregate limit.

A “named insured” on the policy has full rights to the total liability coverages contained on the policy. An “additional insured” is only covered when they are named in lawsuits pertaining to the covered property. This is to prevent an additional insured from being covered on your policy for a lawsuit that has nothing to do with your business.

A Commercial Umbrella will add additional liability coverage to all of the underlying liability policies of the named insured. An Excess Liability policy only provides additional liability limit over one, specified underlying policy.

A Commercial Auto policy contains liability coverage, which will cover you for damages cause by your vehicle, providing you were negligent. It can also cover your owned vehicles for physical damage sustained in an accident (collision coverage) as well as other that collision damage such as fire or theft. You may also purchase coverage on your employees vehicles used in your business and/or rented vehicles by purchasing “hired & non-owned auto” coverage.

Worker’s Compensation is used to protect your employees for any injury sustained while on the job. This will pay for both medical expenses as well as lost wages. Group Disability coverage protects your employees for illness or injury sustained while not on the job. This policy will pay a limited amount of lost wages.

Employment Practices Liability coverage protects the owners and officers of the corporation against discrimination and sexual harassment lawsuits.

This booklet has discussed some of the most important aspects in constructing an insurance policy for hotel owners and property management companies properly. Of course there is much more to properly insuring your business than what is contained in these pages, but I hope I have at least accomplished my main goal of giving you a basic idea of how your insurance policy works and demonstrated that because there are so many variables involved - not all policies are the same.

The next few pages are less educational and more of a selling tool for my agency. We at Niagara Montauk Insurance have the traditional Business Owner’s policies and Commercial Package policies available for your business and we also have some highly specialized products available that were designed with the larger, multi-location, multi-state hotel/property management companies in mind. Please review the next few pages. If anything sparks your interest, just give me a call and I will gladly meet with you at your location to discuss your insurance needs.

OUR HOTEL AND PROPERTY MANAGEMENT PROGRAMS

Because we know that every company is different and each has its own set of specific needs, Niagara Montauk Insurance offers many different products - each one designed to fulfill the different criteria brought about by different sized hotel & property management companies. We believe that we offer enough choices to meet the needs from the smallest one location operator all the way up to the operator with hundreds of locations across the United States. Here are some of the products we offer:

Business Owners Policy

As I mentioned in the first section of this document, the Business Owners Policy is designed for the smaller operation. This type of policy is usually the best choice for hotels under 40 units, smaller shopping plazas and apartment complexes with total building values under \$2,000,000. This type of policy will provide plenty of coverage for the above listed businesses at a very reasonable price. Because this policy contains so many different coverages (although at pre-set limits), it is a very safe bet because it will cover a wide variety of possible losses.

Commercial Package Policy (Traditional)

This policy is mainly used for companies that have ten or fewer mid to large sized locations. A Commercial Package Policy is much better than a Business Owners Policy because you can tailor it to meet your specific needs. A Business Owners Policy will not offer enough coverage to properly meet your insurance requirements. We currently offer the "traditional" Business Owners & Commercial Package Policies in the states of NY, PA, MD, FL, GA, SC, UT, AZ, CT, MI, OH, TN and NJ. If you have locations in states other than these listed, I can only offer you a quote in one of our programs designed for larger companies.

Superior Risk Program/Large Account Program

This program is for accounts that have more than ten locations and/or are located in numerous states. It is actually written as a Commercial Package Policy, with the main difference being the way the premium is determined. The traditional BOP & CPP use rates that are filed with each individual state, so there is little flexibility in their pricing ability. The Superior Risk Program does not rely on filed rates, thus the company can charge whatever they feel is appropriate. The way it usually works is that the insurance company looks at your loss experience for the past 5 years and then determines what the lowest price they are comfortable with will be. Generally speaking, the pricing on this type of policy has a much lower rate per thousand dollars of coverage than the traditional BOP & CPP products. We offer this product to larger companies with locations in any of the 48 states in the continental US.

Self Insurance Trusts

A Self Insurance Trust is when a group of similar businesses pool their money together to "self insure" one another. We do not offer this product because we feel the potential risk is too high due to the fact that there is no insurance company involved. We instead offer the following product that acts very similar to a self insurance trust but with a cap on how much risk is involved for the insured.

PROGRAM FOR LARGE PROPERTY MANAGEMENT COMPANIES

Eligibility

- Entire account must generate a minimum of \$25,000 in premium
- Three year loss ratio must be 40% or less
- At least 75% of company revenues must be generated by the following types of businesses:
 - Franchised Hotels (if non-franchised, annual revenues must be at least \$10,000 per unit)
 - Shopping Malls & Strip Plazas
 - Office Buildings
 - Apartment Complexes

Different methods of insuring your assets

On a traditional insurance policy, the insured pays a dollar amount (premium) to an insurance company. In turn, the insurance company retains 100% of the risk as well as 100% of the profits derived from that risk. Another, less common method for insuring your assets would be to join a self-insurance trust. Generally, a self-insurance trust is formed when a group of similar businesses all pool their premiums into a loss pool, from which all losses are paid. The advantage of this type of program is that the members retain all of the profits for themselves. The downside to this is that the members are also responsible for all of the losses. In the event of a bad year, there is no telling how much money the members would need to kick in to cover all of the losses.

What we are trying to do is create a product that has the best of both worlds. Our program is designed to be both an insurance product as well as an investment product that enables the insured to participate in a portion of the risk normally retained by the insurance company as well as a portion of the profits.

How our program works

First, I need to explain where your premium goes when you have a typical insurance policy. For illustration purposes I will use a hypothetical insurance policy with a \$100,000 premium. Typically, 40% of the premium goes to cover administrative costs, which include re-insurance, broker commissions and all other costs associated with processing business – basically company employees. So out of your \$100,000, only \$60,000 is left to cover losses, Re-insurance is normally purchased to cover losses over 100% of the policy premium. In other words, any losses over \$100,000 on your policy would be paid for by the re-insurance company. Since your premium covers the first \$60,000 and re-insurance pays for losses over \$100,000, the insurance company is putting \$40,000 of their own money at risk. Here are some examples:

- 1.) If your policy only generated \$20,000 in losses in a policy year, the insurance company would make a profit of \$40,000 on your account because the other \$40,000 would go to cover the administrative expenses and re-insurance.
- 2.) If your policy were to generate \$40,000 in losses, the insurance company would make a profit of \$20,000.
- 3.) If your policy generated \$60,000 in losses in a given policy year, the insurance company would break even on your account because it costs them \$40,000 to cover the administrative expenses on your policy.
- 4.) If your policy were to generate \$80,000 in losses, the insurance company would have a loss of \$20,000 on your policy. (\$100,000 in premium minus \$80,000 in claims minus \$40,000 in administrative expenses equals a loss of \$20,000).
- 5.) If your policy were to generate \$120,000 in losses in a given policy year, the company would lose \$40,000 on your account. The reason it would not be a \$60,000 loss is because the re-insurance pays all losses over \$100,000.

So as you can see in the above examples, the maximum potential profits on your \$100,000 policy would be \$60,000. Since the insurance company is only putting \$40,000 of their money at risk, that amounts to a 150% return on investment. On the flip side of this, the maximum potential loss is capped at \$40,000 because the re-insurance prevents it from going any higher than that. This equates to a maximum loss of -100% return on investment.

What our product does is it enables the policy holder to participate in half of the potential profits or losses normally retained entirely by the insurance company. This is accomplished by the policy holder putting up a letter of credit in the amount of 20% of the entire policy premium. In our hypothetical scenario, the policy holder would secure a letter of credit in the amount of \$20,000. This letter of credit would only be accessed if the loss ratio (defined as total losses divided by total premium) were to exceed 60%. As we saw in above example 3, the break even point is a 60% loss ratio. Here is how all five above examples would play out:

- 1.) If only \$20,000 in losses were paid out, the total profit would be \$40,000. Since you absorbed half of the risk, you would be entitled to half of the profit. In this case you would make \$20,000, or a 100% return on investment.
- 2.) If \$40,000 in losses were paid out, the profit would be \$20,000 – of which you would be entitled to \$10,000, a 50% return on investment.
- 3.) If \$60,000 in losses were paid out, there would neither be a profit or a loss. You would neither receive nor owe any money.
- 4.) If \$80,000 in losses were paid out, there would be a \$20,000 loss. In this case you would be responsible for half of that loss. Your letter of credit would need to be accessed in the amount of \$10,000.
- 5.) If \$120,000 in losses were paid out, the total loss would be maxed out at \$40,000 (because the re-insurance kicks in on any losses above that). Your entire letter of credit would need to be accessed by \$20,000. This is obviously the worst-case scenario.

This hypothetical situation only deals with a single policy. In reality the way the loss experience works is based on both the entire group premium and entire group losses – the very same way the insurance company has to handle it. The plus side to this is that if you have a bad year but the group as a whole does well, you will still make a nice return on investment. The down side is that if the group as a whole does poorly, even if you did not, every member must share in the poor results.

The nicest part of this program is that you have the ability to make a very healthy return on investment without actually having to put up any cash. Yes, there is definitely a potential for a loss, but at least you know what the maximum possible loss is up front. If you look at the above eligibility requirements, you will see that in order to qualify for this program your five-year loss ratio must be 40% or lower. Since past loss history is the best indication of future losses, it stands to reason that future loss experience should be 40% or less. This being the case there is a good chance that you will make 50% or more on a line of credit.

As I mentioned above, included in the 40% administrative cost are the broker fees. Basically that means my compensation for running the program. This fee is typically 15% of the total policy premium. This is not an additional expense to you, it is paid to me by the company out of your policy premium. Since I will be responsible for making sure that the loss ratio for the program stays as low as possible, thus maximizing your return on investment, I will also be absorbing some of the risk. I will invest one third of my 15% fee into this program. This should give you peace of mind that I have as much, if not more, to gain or lose with the success of this program. The lower the loss ratio, the more money we all make! I certainly do not want to lose 33% of my entire revenues, so I will make sure that only the best accounts will be admitted into this program.

There is one more very important item that needs to be addressed pertaining to this program. Because claims often take more than one year to settle, it may take a few years before an actual loss ratio for a given policy year can be calculated. For this reason, your letter of credit needs to be kept open for three years just in case the losses end up being larger than expected. It may also delay the issuing of any profit checks. A board of participating members will decide how soon profit checks can be disbursed. This may entail issuing only a portion of the profits while retaining a portion in reserve to cover unsettled expenses. Because it will be participating members deciding this, you can be confident that the reserves will be as fair as possible. In the end, you will receive all money due to you.

As you can see, this program is designed for the insured that wants to take on some of the risk (and its associated profits) of the insurance company but wants to put a cap on the total maximum loss.

Create Your Own Company

If you are a very large company and would like a product similar to the one described above but do not want other hotel/property management companies involved because you don't like the fact that they can have an affect on your total loss ratio, you can have your own program and set your own parameters. The minimum premium for this type of program is \$5,000,000. As you can see, only the largest of companies would qualify for this option.

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