FACING THE RISK: PROTECTING CHARITABLE PROPERTY

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INSURANCE ISSUES FOR CHURCHES AND CHRISTIAN CHARITABLE ORGANIZATIONS

INTRODUCTION

One of the primary responsibilities of the trustees and board members of a charity is the preservation of the organization's property. This is because a charity is considered by law to be a trustee party which holds assets in trust for use in fulfilling its charitable purpose as described in its deed of trust, constitution, statement of faith, bylaws, etc. Therefore many of the statutory and common law responsibilities held by the leaders of charities relate to the preservation of trust property. Charitable gifts including tithes, offerings, donations, designated bequests and endowment funds must be preserved and used for the general or donor-restricted purposes of the charitable trust.

Board members must also ensure that adequate property and liability insurance is in place to safeguard the organization's physical assets and to protect the charity against legal liability. Protection of assets and procurement of proper insurance is a fundamental responsibility for the trustees of an unincorporated church or charity, as well as for the directors and officers of an incorporated charitable entity. If board members do not demonstrate diligence in ensuring that proper insurance protection is in place, they can be held personally liable for any shortfall in the event of an underinsured or uninsured loss of property.

Previous "Facing The Risk" articles have primarily focused on liability insurance coverage issues, including general liability, excess liability and directors and officers liability. This article will focus on basic insurance coverage provisions relating to the protection of charitable property such as buildings, furnishings, equipment and stock. Following is a checklist of some basic property insurance policy considerations which should be clearly understood, reviewed and acted upon in order to ensure adequate protection of your charitable assets:

"ALL RISKS" VERSUS "NAMED PERILS" COVERAGE

Review your current policy to determine whether you have property coverage for only "named perils" such as fire, explosion, smoke, vandalism, windstorm etc., or if you carry broad form coverage for "all risks" of direct insurable physical damage or loss. This broader form of coverage is preferable for a variety of reasons, however even an "all risks" policy does not automatically provide coverage for damage arising from flood, earthquake and water backup from sewers and sump pumps. Coverage for these and certain other perils can sometimes be added by endorsement upon request from your insurer for little or no additional premium.

Coverage can also be obtained for a variety of other types of non-standard property including personal items, money, securities, valuable papers and records, computer equipment and software, glass, outdoor signs and lighting, detached structures, boilers, machinery, electrical equipment and a variety of other property, whether located on or away from your premises.

REPLACEMENT VALUE VERSUS ACTUAL CASH VALUE

Most insurance consumers have the expectation that their insurance policy will provide them with a claim settlement that replaces damaged, lost or stolen property with identical or equivalent "new" property. However many organizations still unknowingly hold policies that do not contain a replacement value provision and instead are subject to actual cash value settlements, including a deduction for physical depreciation. This can result in an unpleasant surprise if the claim payment represents only a fraction of replacement cost. It is therefore important to insist on replacement cost coverage to assure settlement on a "new for old" basis with property of comparable material and quality.

The replacement cost policy wordings offered by many insurance companies stipulate that damaged or destroyed buildings must be reconstructed on the same or adjacent site as the existing structure. Please note that some insurers will remove the standard requirement to rebuild on the existing property at the request of the policyholder. This option provides the organization and its board members with maximum flexibility in the event of an insured loss by allowing reconstruction at a different location.

COINSURANCE

Property insurance policies contain coinsurance clauses which are designed by insurance companies to encourage policyholders to carry adequate amounts of coverage on their property by requiring them to bear a portion of every loss, if they are underinsured. For example a policy containing a standard 90% coinsurance clause would require the insured organization to carry a limit of coverage to at least 90% of current replacement value on their buildings and contents. Failure to do so results in a penalty by making the policyholder a coinsurer to the extent of the coverage shortfall.

In the event of a total loss such as a large fire, the claim settlement would be limited to the total sum insured. However statistics indicate that the vast majority of insured claims are partial losses. Because of this, there is often a temptation to insure only a portion of the building replacement value, especially if the structure is fire resistive and a total loss seems a remote possibility. The problem for insurance companies is that if policyholders are not insuring to full replacement value it can result in insufficient premiums being collected in order to actuarially satisfy loss settlements on a replacement value basis. Therefore under the terms of a coinsurance clause an insurer can insist on a formal independent appraisal at the time of loss to determine whether the coverage amount was at least equivalent to the coinsurance requirement.

Failure to insure to at least the specified coinsurance percentage can be result in a penalty proportional to the amount of the shortfall of coverage in the event of a partial loss.

For example if an organization insuring their property for only half of its actual replacement value sustained an $80,000 partial claim while covered under the terms of a policy containing a standard coinsurance clause it would receive a claim settlement of only $40,000, thereby resulting in a $40,000 shortfall. This underscores the importance of insuring to full replacement value in order to avoid underinsurance in the event of total losses and to avoid coinsurance penalties being assessed in the event of partial claims.

While most insurance companies, brokers and agents are able to provide replacement cost guidelines for various types of building structures, it is often advisable for trustees or board members to obtain a formal independent opinion of replacement value from time to time in order to satisfy their fiduciary and trust responsibilities. Such opinions are available through professional property appraisers or qualified building contractors and are recommended every five to seven years.

Updating replacement values between appraisals can be addressed by applying standard cost index factors readily available through most insurance companies. It is also important to maintain a current inventory including a description and replacement values for all of the organization's contents, including fixtures, furnishings, equipment, stock and any other property owned, leased or rented by the organization.

Organizations that are diligent in maintaining their building and contents coverage in accordance with current replacement value will be rewarded by qualifying for elimination of the coinsurance penalty from their policy. As long as coverage is carried in an amount equivalent to the value indicated in a formal appraisal or statement of values form, most insurers will agree to eliminate the coinsurance penalty and replace it with an agreed value or stated amount clause. There is no additional cost for this upgrade, aside from any premiums associated with increasing coverage limits to comply with the appraised replacement value.

Not only does this arrangement eliminate the possibility of a coinsurance penalty, the process involved in verifying the property value by means of outside professional input helps to satisfy the board's fiduciary duties and trust responsibilities.

BUILDING BYLAWS

Even when an organization is diligent in maintaining their policy limits in accordance with current replacement values based on a formal professional opinion, a major insured loss can still result in a shortfall in coverage. The additional expenses to continue operations during reconstruction and indemnification of any reduction in revenue as a consequence of an insured claim can be addressed through a variety of business interruption coverages (which will be the subject of a future article).

However a shortfall can also occur when the actual costs of reconstruction exceed the strict replication value of the existing structure. Often reconstruction involves additional costs such as demolition of the undamaged portion of the building in a total loss, debris removal, dumping fees and the imposition of updated municipal building codes and bylaws requiring the structure to be rebuilt with certain upgrades such as smoke and heat detectors, sprinklers, fire walls, more expensive fire rated building materials, handicapped access and washrooms. These extra items can all cause actual reconstruction costs to escalate dramatically.

Many policies either exclude coverage for these expenses or limit coverage to within the maximum available building insurance limit. Some insurers offer broad form "bylaws" coverage for these additional costs and provide an excess percentage or dollar amount above and beyond the basic limit of coverage on the building. Coverage to address these contingencies should be arranged to reflect the overall value and age of your building.

SUMMARY

A complete review of property coverage features and issues is beyond the scope of this article. However we hope that this general review of some of the important and often neglected property insurance considerations will assist your board members in better understanding and fulfilling their duties and avoiding unnecessary and potentially costly coverage shortfalls. For more information regarding these issues or for inquiries about the unique coverage features and premium savings available exclusively through CCCC Group General Insurance Plan, please contact our office directly.