

A Guide to Insurance-To-Value And Extra Expenses



For many businesses, it is nearly impossible to continue operations if a fire, windstorm or other peril critically damages their building and/or its contents. In some cases, a business never fully regains its market position. Unfortunately, there's little anyone can do to prevent a disaster from striking.

How quickly and completely your business recovers from severe damage and indirect losses depends heavily on how well you are prepared. When disaster hits, your credit union needs immediate help – including a disaster recovery/business plan and the proper coverage and limits – to restore normal operations and continue serving your members.

However, insufficient insurance is a serious problem that often goes unrecognized until a loss occurs.

Use this guide's quick check steps, worksheets, and the insure-to-value concepts to identify inadequacies of coverage for buildings, extra expense and data processing operations extra expense.

Improving Your Building and Property Insurance-To-Value Equation

Improving your insurance-to-value equation for your credit union properties is a sound way to build upon your credit union's financial security.

How to determine replacement coverage needed for my building(s)?

Since construction costs differ around the country, it's important that a credit union check with a building contractor or appraiser to obtain up-to-date replacement costs. Research supports the fact that many buildings are inadequately covered by insurance for replacement.

What is meant by replacement cost?

Replacement cost is the full cost of replacing the building with new material of a similar kind and quality without deduction for depreciation (different than actual cash value).

Quick Check Steps – Building Coverage Limit

Step #1

Obtain the building limit of insurance from the most recent policy declarations page or insurance review.

Step #2

Obtain the total square footage based on the building's outside dimensions.

- Multiply the length by the width of your building
- Multiply that number by the number of stories of your building

Step #3

Determine the building's "dollar per square foot" reconstruction cost. The construction of each building is very important in determining the replacement cost. Divide the building limit of insurance (step #1) by total square footage (step #2).

Step #4

Contact a local building contractor or professional appraiser and ask if your building could be replaced for the calculated "dollar per square foot" amount.

Building Limit Quick Check Example

Assume a two-story building is 100 feet long and 50 feet wide.

Step #1: Building Limit of Insurance = \$1,000,000

Step #2: 100' x 50' = 5,000 square feet on each floor
5,000 square feet x 2 stories = 10,000 square feet

Step #3: \$1,000,000 / 10,000 square feet = \$100

This building is insured for \$100 per square foot replacement cost.

Replacement Cost versus Actual Cash Value

Replacement cost and actual cash value can often be confused.

Replacement Cost

The full cost of replacing the building with new material of a similar kind and quality without deduction for depreciation.

For example if the cost to rebuild your building today is \$1,000,000 and depreciation is \$200,000 – the replacement cost is \$1,000,000.

Actual Cash Value

The current replacement cost of the building, less depreciation.

Using the same example, the cost to rebuild your building today \$1,000,000, and the current depreciation is \$200,000. Therefore the actual cash value of the building is \$800,000.

Which is the preferred way to set limits of insurance?

The large majority of credit unions want to insure their buildings for the replacement cost; however, some credit unions have situations where actual cash value is an appropriate coverage.

Are there any disadvantages to insuring building(s) to actual cash value?

Yes, in the event of a total or partial loss, the actual claim payment would probably not be enough to repair, replace or rebuild your current building.

Understanding Coinsurance Conditions

The term “coinsurance” refers to the need to carry a limit of insurance equal to a specified percentage of the value of the property and is the foundation for determining the loss payment for a total or partial loss.

With CUNA Mutual Group’s Property & Business Liability Policy (PBL), the Coinsurance Condition is always 100% unless a different percentage is specifically listed on your PBL Declarations Page or an Agreed Value Endorsement is added.

You can use a standard formula to see how a coinsurance condition impacts the building replacement cost at the time of a loss.

1. Divide the Limit of Insurance by the Building Replacement Cost at time of loss to determine the Percentage Multiplier
2. Multiply the Dollar Amount of Loss by the Percentage Multiplier to determine the potential Claim Payment Amount

These calculations and examples demonstrate how a loss payment could be affected by coinsurance and have been simplified by assuming no deductible and 100% coinsurance.

Example 1 – Total Loss

Building with replacement cost of \$750,000 has a limit of insurance of \$750,000 (insured to 100% of replacement cost). Building incurs a total loss.

1. $\$750,000 / \$750,000 = 1.00$ or 100%
2. $\$750,000 \times 1.00 = \$750,000$

The credit union would be reimbursed for the total loss.

Example 2 – Partial Loss

Building with replacement cost of \$750,000 has a limit of insurance of \$562,500 (insured to 75% of replacement cost). Building incurs a partial loss of \$250,000.

1. $\$562,500 / \$750,000 = .75$ or 75%
2. $\$250,000 \times .75 = \$187,500$

The credit union would not be reimbursed for the full loss. The credit union would be reimbursed \$187,500 and responsible for the balance of \$62,500.

Example 3 – Partial Loss

Building with replacement cost of \$750,000 has a limit of insurance of \$375,000 (insured to 50% of replacement cost). Building incurs a partial loss of \$150,000.

1. $\$375,000 / \$750,000 = .50$ or 50%
2. $\$150,000 \times .50 = \$75,000$

The credit union would again not be reimbursed for the full loss. The credit union would be reimbursed \$75,000 and responsible for the balance of \$75,000.

The Coinsurance Condition does not apply to a covered loss of \$100,000 or less under CUNA Mutual Group’s PBL Policy.

Key Issues to Determining Extra Expenses

Properly determining and reviewing limits involves more time and effort than one usually anticipates. However, the time spent can be the determining factor in accuracy.

Extra Expense is the necessary extra costs you incur to minimize the suspension of your business and allow you, as soon as possible, to continue operating your credit union as close to normal as practicable, after a covered loss.

Some frequently overlooked issues in determining extra expenses include:

- Not considering the loss as a worst case scenario.
- Not considering politics and ordinances when determining the recovery timeline.

For example, securing a building permit from the city planning board and/or meeting new building codes requirements can take significant additional time (several months) and may increase costs.

- Allowing sufficient construction time for building a better and newer building, especially considering weather delays, building code issues, and demand for resources.
- Due to the high volume of equipment requests from other businesses and a limited supply in a disaster zone, increased costs can be associated with the necessary equipment.

Quick Check Steps - Extra Expenses & Coverage Limits

Extra Expense and Data Processing Operations Extra Expense Quick Check Worksheets

The Quick Check Steps and Worksheets will help your credit union understand the extra expenses you may incur if a disaster situation occurs. Use the extra expense calculations to determine and/or validate coverage limits.

Step #1

Determine one-time costs incurred immediately after the disaster and during the period of restoration for temporary location expenses, staff expenses, increased labor expenses, hot site expenses, and other extra expenses.

On the Quick Check Worksheets, enter these amounts on the appropriate line in column A. After all have been entered, add the totals for all entries in column A.

Step #2

Determine additional monthly ongoing costs incurred during the period of restoration. It is important that these costs are identified as ongoing rather than one-time expenses.

On the Quick Check Worksheets, enter these amounts on the appropriate line in column B. After all have been entered, add the totals for all entries in column B.

Important Information

Make sure to subtract any expenses normally incurred had the disaster not happened.

For example, the location being restored is a rented location for which you normally pay \$800 per month. The temporary location costs \$1,500 per month, so your total extra expenses would be \$700 per month during recovery time (\$1500 temporary rent expense - \$800 normal rent expense = \$700 extra rent expense). **If your current location lease requires you to continue to pay the \$800 even if the building is inhabitable, the extra expense will be \$1,500.**

Step #3

Estimate the number of months needed to complete restoration following a reasonable worst case scenario.

On the Quick Check Worksheets, enter the number of months at the top of column C. Calculate your total monthly expenses by multiplying column B by the number of months deemed necessary for restoration in column C.

Example

If rental furniture is \$1,000 per month and the estimated recovery time is six (6) months, your total monthly expense for rental furniture will be calculated as \$6,000.

Step #4

To determine the estimated limits: add the totals of columns A and column C and enter the amount at the bottom of the Quick Check worksheet.

Instructions on how to use the quick check worksheets as a fillable PDF

- Enter the estimated costs of both one-time and monthly ongoing costs, in addition to the anticipated # of months for restoration.
- Enter line-item amounts in the appropriate column.
- The Quick Check Worksheet will automatically total your estimated limit based on your entries.

Extra Expense Quick Check Worksheet

	Column A One-Time Costs	Column B Monthly Costs	Column C Monthly Costs x Restoration Time
EXPENSE DESCRIPTION			# of months: _____
Temporary Location Expenses			
Location rental including broker fees and on-site mobile units			
Maintenance at temporary premises			
Alterations at temporary premises			
Cost of equipment purchased that will not be used at permanent location (less resale or salvage value)			
Rental of temporary furniture, fixtures, and equipment			
Moving to and from the temporary premises			
Operations installation			
Light, heat, and power			
Telephone and other communications			
Insurance			
Security guards at temporary location			
Other:			
Staff Expenses			
Overtime staff pay to maintain service and service level (necessitated by loss)			
Employee travel allowances			
Vehicle rental			
Other:			
Other Expenses			
Special advertising (radio, TV, newspaper, etc. announcements)			
Cost of work performed or services purchased from outside vendors (during interruption of normal operations)			
Hired security to protect the damaged location on a 24/7 basis until it is fully secured			
Other:			
Other:			
	Add all entries in Column A ↓	Add all entries in Column B ↓	Multiply Column B Total by # of months ↓
TOTALS			
	Total One-Time Costs	Total Monthly Costs	Total Monthly Costs During Restoration

Estimated Extra Expense Limit
(add Column A Total and Column C Total)

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Data Processing Operations Extra Expense Quick Check Worksheet			
	Column A One-Time Costs	Column B Monthly Costs	Column C Monthly Costs x Restoration Time
EXPENSE DESCRIPTION			# of months: _____
Increased Labor Expenses			
Data processing staff overtime			
Temporary data processing staff			
Security guards to protect the data processing operations following power outage			
Other:			
Hot Site Expenses			
Hot site costs			
Expenses to send and maintain staff at hot site			
Alternative site rental to house data processing operations			
Other:			
Other Expenses			
Generator rental to power data processing operations following outage			
Generator fuel			
Data processing equipment rental			
Increased utility cost due to loss			
Cost of temporary data processing lines to main facility or rental facility			
Telephone and other communications installation			
Other:			
	Add all entries in Column A ↓	Add all entries in Column B ↓	Multiply Column B Total by # of months ↓
TOTALS			
	Total One-Time Costs	Total Monthly Costs	Total Monthly Costs During Restoration
Estimated Data Processing Operations Extra Expense Limit (add Column A Total and Column C Total)			

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