Insurance Issues with Vacant or Unoccupied Buildings

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In the last year the world has seen unprecedented economic issues and depending on the economist or forecaster the country is either starting to rebound or just getting ready for the next wave of commercial property foreclosures. Within the United States office buildings, shopping centers and residential neighborhoods with either partial or complete vacancies have been in existence for some time. The Puget Sound region is starting to feel the impact of this crisis and see formerly stable tenants default on their lease and shut their doors.

As part of your overall risk management strategy it is important to understand how this will impact not only your renewal pricing but also coverage on the building. This should be a standard discussion point as part of your pre-renewal strategy meeting well in advance of your renewal. The vacancy issue is significant and many insureds are not aware their coverage can change if a building is left vacant for a period of time. Vacant and unoccupied are terms that can be used interchangeable, but in general underwriters are not excited about extending coverage to a building that is vacant or unoccupied. Insurance Companies typically consider buildings to be vacant if less than 30% of the building is occupied. Buildings under construction and renovation are typically not considered to be vacant.

If you have a vacant building the first thing to consider is asking the underwriter waive the vacancy provision. Many underwriters will agree to waive this provision if they receive assurance the building is property secured via hard wired alarm monitoring, security patrols and cameras where appropriate. Insurance companies have suffered many claims due to loss of copper wiring, equipment, interior materials, etc. The best way to present a vacant building is to have a good security system in place and notify your broker immediately when any of your properties look like they might be close to becoming vacant. Many property insurance policies will convert to Actual Cash Value and/or reduce the coverage provided for buildings that are vacant over a certain number of days. It is important that owners are communicating with their brokers anytime a building is unoccupied so the broker can negotiate an extension or best case get the underwriter to agree to waive the vacancy provision.

The most obvious issue for a landlord is they are now continuing to pay the mortgage and maintenance on a property with no revenue stream.

The other issues we see clients struggle with are how to calculate an accurate business income value for the policy. The property might be fully or partially occupied right now but there could be concerns about retailers or tenants continuing to stay in their space for the next twelve months. Do you use the full occupancy value or reduce to match your current revenue stream. It is going to be important that you are communicating with your broker on a regular basis what is happening at your properties, how your tenants are performing and reviewing not just the overall rental income values but also the rent rolls. In many cases lenders will not allow clients to reduce their rental income limits and they are requiring landlords to insure for eighteens months of rental income. In some cases a landlord may have the ability to negotiate this provision out of lending agreement prior to signing in other cases it may involve working with the lend midterm to help them understand where the occupancy stands today.

Insurance carriers typically pay loss of rental income based on your historical rental income and you have any new future signed leases that may come under consideration. We recommend you look at these values annually and adjust as appropriate.