

Avoiding Gaps in Commercial Property Insurance

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Insurance issues are pervasive in real estate transactions. Follow these tips to ensure that your client has adequate commercial property protection and to help your client avoid litigation with the insurance agent down the road.

Ensure the policy names the proper entities

One of the most serious coverage issues is not listing the proper entity that owns the property. Today, in the face of many limited liability companies, list all such entities to avoid insurable interest arguments at the time of a claim.

Use caution in requiring tenants to insure a landlord's property

Many landlords require a tenant to insure the building. This is usually a major mistake. A tenant will often only list the landlord as a loss payee. However, doing so gives a landlord no independent rights to coverage or even to negotiate with the insurer on a claim. Further, it presupposes that the tenant's insurance agent is competent to insure the landlord's assets.

Pay attention to the business interruption coverage provisions

Business interruption coverage is not often given the attention it deserves. Many companies only insure a year of lost revenue and extra expenses. If your client loses a major customer while repairs are completed, the business interruption may last longer than the typical coverage. Be sure to avoid coinsurance penalty provisions in business interruption coverage forms. In addition, negotiate an unlimited or extended period of indemnity on a business interruption coverage form. Regardless of the limit of insurance for lost income, the insurer will stop paying when the building is rebuilt or with reasonable diligence should have been rebuilt plus 30 days. Many insurers will offer longer periods to cover you while you regain market share. This is particularly important in manufacturing- and landlord-type risks.

Avoid a coinsurance provision in the building and contents coverage

A coinsurance provision could make the client a "coinsurer" of a property loss if inadequate insurance was maintained. This should be avoided through negotiation with the insurer before the issuance of the policy.

Ensure that your policy includes adequate limits for replacement costs for building and contents

One of the most significant underinsured property losses is in the area of inadequate limits for building and contents. It is important to base limits on replacement cost and not market value and to revisit these limits each year. Make sure to include leasehold improvements in your calculations. Debris removal costs should be taken into account. See tip 7.

Obtain a single overall blanket limit that combines the limits for all buildings and contents

Having a single blanket limit for all buildings and contents when there are multiple locations is a safety net in the event of inadequate limits at any one location. For example, if there are three locations with a replacement value of \$1,000,000 each, never accept three separate limits. Instead, have one blanket limit of \$3,000,000 that applies to any one location.

Always factor in debris removal costs into the building valuation

The value insured for buildings will include the expense of debris removal. Therefore, this must be factored into the limit. Most policies give you only 10 percent of the building limit to pay for costs to remove debris plus a small additional sum, such as \$10,000. Attempt to negotiate higher debris removal limits.

Negotiate away a protective safeguards endorsement

Some insurers require this endorsement and provide a discount for a fire suppression system or a burglar alarm. Problems arise if the system does not work. The insurer may refuse to pay a loss.

Purchase coverage for rebuilding in compliance with laws, ordinances, and building codes

Building codes change. For example, following a fire your client may be required to rebuild in a different, more costly manner such as adding an elevator, installing a sprinkler system, using more expensive metal trusses, etc. Similarly, you can purchase additional business interruption coverage to cover delays in rebuilding associated with complying with building codes and ordinances.

More on this topic

- *Michigan Insurance Law and Practice* (see chapter 10)