



**CAMBRIDGE**  
PROPERTY & CASUALTY

## ***A CAMBRIDGE COVERAGE UPDATE FOR ATTORNERYS AND THEIR CLIENTS***

### **VACANCY PROVISIONS IN PROPERTY INSURANCE POLICIES:**

**DOWNTURN IN REAL ESTATE MARKET PLACES SOME CLIENTS IN  
PRECARIOUS POSITION OF AUTOMATIC COVERAGE SUSPENSIONS**

### **INTRODUCTION**

Commercial and personal property insurance policies routinely contain provisions on vacancy that have become increasingly more important in the recent difficult economy where many properties are vacant for a lengthy period of time. The purpose of this article is to discuss the implications of these provisions and to underscore the importance of advising your real estate and business clients on this issue to be certain that you are not left with a serious gap in coverage in the event of a property loss to a vacant structure. These provisions not only apply to landlords but also to tenants and home owners.

### **COMMERCIAL VACANCY TRENDS IN METRO-DETROIT**

According to the National Association of Realtors (NAR)<sup>1</sup> in June of 2008, the economic slowdown and the credit crunch are beginning to cause significant damage to the commercial real estate market. Other numbers from the NAR:

**Office:** Vacancy rates are projected to increase to 13.7 percent in the fourth quarter of this year from 12.5 percent in the fourth quarter of 2007.

**Industrial:** Overall vacancy rates in the industrial sector are forecast to rise to 9.9 percent in the fourth quarter of this year, up from 9.4 percent in the same period of 2007.

**Retail:** Retail spending has been hurt by high oil prices with consumers throttling back on their spending habits. Vacancy rates in the retail sector will probably edge up to 9.3 percent in the fourth quarter from 9.2 percent in the fourth quarter of 2007.

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<sup>1</sup> www.realtor.org

**Multi-Family:** Multifamily vacancy rates are likely to rise to 5.7 percent in the fourth quarter from 4.8 percent in the fourth quarter of 2007. Average rent is forecast to rise 4.0 percent in 2008, up from a 3.1 percent increase last year.

Vacancy rates for buildings have been increasing in metro Detroit at a faster rate than in Michigan and nationally, caused by bank foreclosures, increasing unemployment and a downturn in the real estate market.

### **HOW ARE VACANT BUILDINGS AFFECTED BY INSURANCE?**

Many insurance buyers are not aware that there are serious insurance issues associated with vacant homes or commercial buildings.

As respects commercial buildings, most property policies contain a standard vacancy provision that provides:

“If the building where loss or damage occurs has been vacant for more than 60 consecutive days before that loss or damage occurs:

- (1) We will not pay for any loss or damage caused by any of the following even if they are Covered Causes of Loss:
  - (a) Vandalism;
  - (b) Sprinkler leakage, unless you have protected the system against freezing;
  - (c) Building glass breakage;
  - (d) Water damage;
  - (e) Theft; or
  - (f) Attempted theft.
  
- (2) With respect to Covered Causes of Loss other than those listed in paragraphs (1)(a) through (1)(f) above, we will reduce the amount we would otherwise pay for the loss or damage by 15%.

(Emphasis added.)

The above provision can be daunting to say the least and we find that many commercial property owners are unaware of the far-reaching implications of this condition, which automatically applies. In short, coverage is automatically suspended in its entirety for vandalism, water damage and theft, for example, if the building is vacant for more than 60 consecutive days before the loss.

### **WHEN IS A COMMERCIAL BUILDING CONSIDERED “VACANT”**

According to most commercial property policy forms, if the insured is a building owner, the building is vacant unless at least 31% of its total square footage is either rented and used to conduct customary operations, or used by the building owner to conduct customary operations.

For tenants, a building is considered vacant when it does not contain enough business personal property to conduct customary operations.

An issue is what the phrase “conduct customary operations” means. An insurer could take the position that it is not the customary operations of a building owner to use the building for its own storage, for example.

### **RESIDENTIAL VACANCY ISSUES THAT COULD AFFECT YOUR CLIENTS**

According to the U.S. Census Bureau, vacancy rates for owner-occupied homes in Detroit were at 4.1%, compared with a 3.8% in Michigan and 2.8% nationwide.

Some homeowners’ insurance companies have significant coverage limiting provisions in the event of vacancy. For example, most insurers will exclude coverage for freezing while the building is vacant or unoccupied unless the insured has used diligence to drain the water systems or maintain heat and also exclude coverage for vandalism or theft if the dwelling is vacant for more than 30 days. This is even more limiting than the commercial form which requires 60 consecutive days.

One insurer even goes as far as to exclude coverage for fire if the dwelling has been vacant for more than 60 consecutive days prior to the loss.

### **UNDERWRITING ISSUES THAT COULD FACE YOUR CLIENTS**

At the inception of the policy, the insured needs to be cautious about not representing that the building is occupied if it is not. Note that in Michigan the independent insurance agent is the agent of the policyholder and that if the agent completes the application indicating that the building is not vacant, that could be binding upon the insured and later serve as a basis to negate coverage.

Insurance carriers have not been reluctant in recent times to attempt to rescind the insurance policy and return the premium to the insured if it is discovered that there was a material misrepresentation when the application was completed.

### **SOME SOLUTIONS FOR YOUR CLIENTS ON VACANCY ISSUES**

1. Read the policy. Whether your client is a landlord, tenant or homeowner, be certain to advise them to carefully read their property or homeowners policy to assure that they completely understand the vacancy condition. Ask the insurance agent for clarification.
2. If your client rents their home to someone else, be sure they are not insured on a homeowners policy. Homeowners policies are only for owner-occupied structures. A separate policy is necessary in this situation.
3. Be upfront with the insurance agent about any vacancy issues. There can be solutions to the coverage gaps.
4. Suggest that your client ask for a vacancy permit from the insurer, through their agent, if the building is temporarily going to be occupied for longer than the time period allowed by the policy. Many commercial insurers will provide such an endorsement that will suspend the vacancy condition for a period of time if it can be shown that the appropriate measures are being taken by the insured such as routine site visits, alarm systems, etc.

5. Suggest that your client use an insurer that does not have a vacancy provision, if possible. There are not many such insurers out there but some commercial insurance companies do not have such a provision in their property policies. Of course, the insurer will always be concerned about the increased likelihood of a loss at a vacant building.
6. Alternative policies are available for vacant buildings and homes. Many insurers now offer alternative policies for vacant properties. While such policies are more expensive than standard policies, they would provide broader coverage in certain areas. However, some carriers may limit this kind of policy to actual cash value coverage as opposed to replacement cost insurance so be cautious in understanding this from the inception.
7. Do not rely upon a tenant to insure your client's property. In such case, the building owner may be completely unaware of any vacancy provisions in the policy maintained by the tenant.