Protecting your vacant building:

How to reduce the risks and become more aware of coverage pitfalls

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Inflated vacancy rates are still pervasive throughout the country

Despite mild improvements in the economy since the worst point of the recession, high vacancy rates continue to plague commercial properties in multiple sectors, especially in less desirable locations or regions particularly hard-hit by the economic downturn — creating risk-related challenges for property owners, investors and developers.

The uncertain, if not sluggish, economy persists with an unemployment rate of 8.3 percent as of July 2012, according to the Bureau of Labor Statistics. While the most recent unemployment numbers are a vast improvement from rates exceeding 9 percent a few years back, economic growth and hiring remains tempered or slow throughout most of the country. As a result, fewer people are working in office space, shopping in retail space or manufacturing goods in industrial space — keeping these sectors' vacancy rates steady at inflated levels or only slightly improving.

The national office vacancy rate held firm at 17.2 percent in the second quarter of 2012, unchanged from the first quarter, according to information from Reis Inc., a New York firm that tracks commercial property; during the second quarter of 2012, vacancy rates for neighborhood and community shopping centers, and super-regional and regional malls decreased by 10 basis points to 10.8 percent and 8.9 percent respectively, according to information from Marcus and Millichap Real Estate Investment Services; and the U.S. industrial vacancy rate remained flat at 9.1 percent in the second quarter of 2012, according to information from commercial real estate services firm Cassidy Turley.

Even though multifamily housing has been the darling of the commercial real estate market — with second quarter 2012 vacancies hitting their lowest point since 2001 at 4.7 percent, according to Reis information — higher vacancies still persist in some areas like Memphis, Tenn., with its 9.2 percent vacancy rate.

Regardless of overall vacancy rates, the longer a building remains unoccupied, the more that risks associated with vacant properties increase, along with the potential for expensive litigation and losses. In addition, vacant properties can affect certain aspects of your property insurance.

This paper discusses the implications vacant buildings may have on your insurance coverage and presents some possible solutions to help protect unoccupied commercial property. It will also identify potential hazards posed by vacant buildings and recommended measures real estate owners can take to reduce these risks and control losses.

Before addressing these issues, for the purpose of this paper, it will be useful to define the meaning of "vacancy" in commercial properties.

"Vacancy" – do you and your insurance carrier define it the same way?

A good understanding of the term "vacant" is the first step to help select proper coverage and reduce the exposures inherent in vacant properties. According to the Merriam-Webster dictionary, the word vacant is defined as "being without content or occupant." But the insurance industry uses a slightly different definition.

The type of occupancy affects the definition used by insurance companies, for example: (Building and Personal Property Form CP 00 10, the Insurance Services Office (ISO), 2009):

- Property owner or general lessee – A building is considered vacant unless at least 31% of its total square footage is rented to a lessee or sub-lessee to conduct its customary operations and/or used by the property owner to conduct customary operations.
- Buildings under construction – Buildings that are under construction or renovation are not considered to be vacant.

When defining vacant properties, it is also noteworthy to realize how traditional exposures have changed in light of the current economic situation. In the past, vacant properties were primarily commercial or industrial buildings and lots that posed a threat to public safety. They could include abandoned, boarded-up buildings, unused lots that attract trash or debris, vacant or underperforming commercial properties known as greyfields (such as under-leased shopping malls and strip commercial properties), and neglected industrial properties with environmental contamination known as brownfields. Neglected by their owners, the vacant properties became crime magnets, fire hazards, or dumping grounds.[1]

This is not necessarily the case in today's real estate market. Buildings may become vacant because major tenants are forced to move out due to the sluggish economy and the space takes longer to fill. Many of these vacant properties are newer, high-quality structures, fire resistant equipped with sprinklers and supervised daily by watchmen. These may also be brand new buildings built on spec whose developers find it difficult to attract buyers.

What happens to your insurance coverage when your building becomes vacant?

The existence of vacant commercial property may potentially create changes in a real estate owner's insurance coverage. Most policyholders are not aware of the restrictions in their property insurance when a building is vacant. The ISO (Insurance Services Office) property form, found in most commercial property policies, addresses vacancy by including provisions such as:

1. If a building is vacant for more than 60 consecutive days before the loss occurs, there is no coverage for loss caused by the following perils:
   - Vandalism
   - Building glass breakage
   - Water damage
   - Theft or attempted theft
   - Sprinkler leakage (unless the insured has protected the building against freezing)
2. Also, with respect to any other covered cause of loss, e.g., fire or wind, the amount that would otherwise have been paid for loss or damage is reduced by 15 percent.

This provision is of particular concern to owners of properties containing multiple tenants, one of which makes up a majority of the building — for example, a 12-unit strip mall in which a grocery store leases five of the 12 units. In this situation, the loss of that largest tenant could trigger the vacancy provision, which can potentially drastically limit or, in certain instances, exclude coverage, change deductibles or cause the underwriter to non-renew or to cancel your policy.

Solutions

Being aware of the vacancy provision in the property policy can help reduce the potential likelihood of litigation and losses. This is why it may be essential to take the following steps:

- Notify your insurance company about the vacancy so proper coverage can be continued under the policy.
- Review the policy terms and conditions applicable to vacant property. Vacant commercial buildings may cost more to insure than occupied commercial buildings because they often have more exposure to losses. Thus, continued, full coverage may often require additional premium.
- Check with your carrier to determine if the vacancy provision applies. Zurich's policy, for example, does not have a vacancy clause. Zurich understands that there's been a fundamental shift in the exposures of vacant properties and is prepared to underwrite them without any reduction in coverage.
- Consider a property insurance endorsement that suspends some or all of the coverage restrictions that apply to buildings that have been vacant for more than 60 days. Some carriers offer an endorsement, vacancy permit, which reinstates coverage for the types of losses mentioned above. This endorsement may require additional premium.

Potential hazards posed by vacant buildings

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A commercial building sitting empty is already costing its owner by way of not generating income. Some real estate owners prefer to save on claims and underwriting fees by taking a high deductible. Now, it is even more important than ever to identify and address risk issues involving vacant properties to prevent costly losses.

Primary causes for increased risks in a vacant property include:

- Fire
- Mold
- Water leakage
- Crime
- Theft
- Weather-related damage
- Damages resulting from lack of maintenance or supervision
- Environmental risks

Vacant properties may attract trespassers, arsonists, thieves or other criminals. Copper thieves target vacant buildings, especially those that are not secured and without power. A study in Austin, Texas, found that "blocks with unsecured [vacant] buildings generate 1.8 times as many theft calls and twice the number of violent calls" as blocks without vacant buildings.[2]

Fires in vacant buildings have become a matter of increasing concern as the economy has weakened. According to the report by the National Fire Protection Association, in 2003-2006, U.S. fire departments responded to an estimated average of 31,000 structure fires in vacant buildings per year. These fires resulted in $642 million in direct property damage per year.[3]

Guidelines to protecting your vacant property

While each of the property classes, including office, retail, industrial and multi-family, may have its own unique exposures, there are general guidelines that real estate owners and managers can adopt to prevent or mitigate the hazards to protect their vacant buildings.

Communication

- Notify local authorities and public sector emergency response organizations, including police and fire departments, that your building is unoccupied. Provide them with your contact information in case of an emergency.
- Advise utility companies of the vacancy. Ask to be contacted in the event of high usage or emergency.
- Inform your insurance company that you have a vacant building. Review your policy to ensure your vacant building is properly covered.
- Advise your alarm company of the vacancy, create new codes and update contact information.
- Talk with other building owners in the area and ask to be notified in the event of emergency.
- Suspend mail and delivery services to the building.

Weather

- Install low temperature alarms connected to a listed central station in a building where the water remains on to prevent damage from cold or freezing temperatures.
- Adjust the thermostat, where appropriate:
  - Set central heating to 55 degrees to keep the pipes from freezing.
  - Adjust the air conditioning to 85 degrees to protect against humidity and mold.
- Plan for rain, high winds and storm. Keep any exterior furniture inside and close all doors, windows and vents to prevent from wind and rain.
- If appropriate, plan for catastrophic events, such as hurricane.

Maintenance

- Keep all sprinkler, fire protection and detection systems in service.
- Check weekly sprinkler control valves, fire extinguishers and other fire protection equipment.
- Operate boilers to provide heat to prevent freezing of fire protection equipment (water supply tanks, sprinklers, sprinkler piping, etc.).
- Test all fire protection system alarms quarterly to ensure they are still working.
- Inspect the roof, if accessible, to evaluate any potential exposures such as clogged roof drains, rooftop structure damage from recent storms, vegetation growth, or evidence of unauthorized access via roof hatches, skylights or stairwell doors.
- Keep heat or smoke detection systems in service.
- Ensure any sump pumps are working properly.
- All utilities not necessary for protection or security, should be turned off in the building (e.g., shut off to the water heater, the supply line to the water heater).

- Prevent leaks by checking and keeping the gutters clean and insulating pipes.
- Maintain alarm systems in the event of pipe breakage to prevent water damage.
- Caulk seams and cracks in door and window frames, vents, roofs and siding.

Supervision

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- Conduct frequent regular "walk-through" tours of the vacant property at different times of the day to note any changes. Consider hiring a guard service.
- The frequency of tours depends on the value of a location, ranging from a minimum once a week for low-valued property to several visits a week for a high-valued building.
- During visits, survey general conditions, including:
  - The exterior of the building to note if there are any signs of vandalism or trespassing.
  - The interior tour of the building should include all areas.
- Ask the local police department to include your building in a night tour if you notice any vandalism or attempts at entry into the building.

Security

- Secure all doors and accessible windows with deadbolt locks. Consider installing additional locks.
- Make sure security systems are in place and operational.
- Ensure proper lighting:
  - Maintain exterior and interior lighting.
  - Install exterior and interior motion or timed lighting to help prevent potential animal infestation and criminal activity.
- Consider letting a non-profit organization occupy your property at no charge to maintain the property.
- Make the property appear occupied to minimize the risks of vandalism and other crimes. Maintain the exterior by cutting grass, removing leaves or snow.

Protection from environmental risks

- Remove any debris or hazardous materials, including unnecessary combustibles, pollutants or chemicals, to eliminate the potential for fire, leaks or contamination.
- Develop specific damage-mitigation plans for mold by evaluating your portfolio's exposure to the problem. Consider such factors as construction materials and geographic location.
- Turn off electrical equipment.
- Secure flammable liquid tanks by removing them or filling them with sand or concrete.

Real estate owners can personalize loss-control measures based on the type of risks their company is experiencing. Are your loss dollars coming from weather-related hazards? Are fires or water leakage the largest risks to your portfolio of properties? Once you identify your primary risks, you should develop a prioritized list of loss-control steps that will address these recurring losses.

Conclusion

One of the side effects of the current economy is the increased likelihood of claims involving vacant buildings. Vacant building losses often create difficult loss settlement situations for everyone involved. Most commercial property policies, in general, contain a condition limiting or reducing coverage for certain causes of loss on a building that is vacant beyond a certain period of time. This is why reviewing the property policy, in particular, makes good sense.

In addition, vacant properties pose more hazards than occupied buildings. If real estate owners increase protective safeguards, such as proper maintenance, security and regular supervision of the vacant property, they can minimize risks and help reduce costly losses.

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