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SMART COVERAGE STRATEGIES FOR VACANT PROPERTIES

Although the economy is improving, the real estate market is still glutted with vacant residential and commercial properties. These valuable, prime real estate assets need protection, creating revenue opportunities for carriers that possess the underwriting skill and loss control commitment to handle this challenging class.

By Michael P. Voelker

Economic downturns lead to increases in vacant properties. Therefore, it's no surprise that the national vacancy rate exploded in the years that followed the onset of the mortgage crisis and 2008 recession. The number of vacant commercial and residential properties has grown dramatically over the last few years, with over 14 million vacant homes in the U.S. as of June 2012—a 2 million increase from 2006—and commercial office and industrial vacancy rates exceeding 20% in some metropolitan areas.

The fast and severe onset of the downturn, which followed a building boom, created a vacancy landscape much different than that to which insurers had become accustomed. "It's no longer just run-down properties that are vacant," explained Roxanne Logan, P&C Underwriting Manager, Special Risk Division, Burns & Wilcox. "Today it's often new construction—well maintained buildings, but empty."

Logan's comments were part of a recent PropertyCasualty360 web seminar, "Smart Coverage Strategies for Vacant Properties." American Agent & Broker Editor in Chief Laura Toops kicked off the session, noting that the occupancy rate is slowly increasing along with an improving economy.

"The national vacancy rate is still above average," she said. "However, the current homeowner vacancy rate is lower than last year and last quarter. There is incremental improvement and things are starting to stabilize, in part because the inventory of homes is shrinking. Realtors are predicting a gradual decrease in retail vacancies, and an even more dramatic decrease in industrial vacancies."

The National Association of Realtors predicts a drop in retail vacancy to 10.9 percent in 2013, down from 13 percent in 2010, and a drop in the industrial rate to 10.7 percent, down from 14.5 percent over the same time period. Experts also predict that housing starts will nearly double and home prices will begin to rise in 2013, with prices increasing significantly in 2014.

"It's a rosy forecast, but what they're predicting," Toops said.

MARKET DEMAND

Historically, standard carriers avoided vacant buildings and penalized owners of them through higher rates and coverage restrictions. However, a few years ago, carriers began to pursue vacant properties as a desired class of business. By 2010, vacant business was aggressively pursued by many standard market and E&S carriers.

For insurers of vacant properties, today's uptick in occupancy rates is a double-edged sword. A decreasing number of vacant properties shrinks the market for carriers looking to grow the class. At the same time, burgeoning demand for building materials, spurred by construction and renovation, makes vacant properties increasingly attractive targets to thieves and increases insurers' theft losses.

"Nearly 50% of the demand for copper comes from construction, so thieves target copper," said Logan. "The loss isn't just from stealing the pipes, but damaged caused by ripping up the building itself."

Vacant properties also present an array of other exposures: fire and arson, vandalism and malicious mischief, freezing of plumbing, sprinkler leakage, and glass breakage, to name a few typical property losses. Liability also exists in the form of injury to people who may be on the site of vacant properties and damage to adjacent property due to poor maintenance. Underwriters also have to be concerned with moral hazard as the owners of vacant properties come under financial pressure and look to their insurance policies for relief.

Logan pointed to some real-world examples of vacant property risk: a trip and fall claim that exceeded $30,000; water damage to freezing pipes in excess of $75,000; and theft of entire building's copper tubing and wires that totaled over $275,000.

"Thieves were in the building for the whole weekend over Christmas, and they stripped everything. No one was there to check on the building so they took their time," she said. As the value of materials has gone up, so have insurers' losses, leading to some market tightening on theft coverage.

Nevertheless, capacity in the market is strong. Nearly 80 percent of session attendees reported offering coverage on vacant properties. Logan reported that the marketplace continues to offer building and personal property coverage under both basic and special cause of loss forms, as well as theft coverage on a case-by-case basis. Liability limits of up to $1 million occurrence / $2 million aggregate are commonly available, along with vacancy permits for normally occupied properties that are undergoing a temporary vacancy.

REDUCING RISK

Jeff Shearman, Senior Risk Engineering Consultant, Zurich Services Corporation, offered several vacant facility considerations to help carriers to reduce risk. If combustibles remain in the facility, fire protection systems should be kept in service. If all combustibles are removed, owners should consider removing fire hoses and fire extinguishers to minimize the risk of both freezing and theft, but authorities should be informed of any systems that are removed from service. Domestic water should be shut off to facilities and water tanks should be drained in unheated areas. Buildings should be maintained to a minimum temperature of 40 degrees.

Security systems should be kept in service, and housekeeping is also important. If sheds or portable buildings are on site, empty or remove them, along with chemicals from the property that could spill or be stolen. Clear out maintenance and housekeeping areas.

"One of the most important things you can do is perform regular, though not predictable, tours that check building status and access points," Shearman said, adding that owners should update emergency contact information with local authorities and that even a quick exterior inspection to look for damage can be important. "Broken windows are common in vacant buildings and those pose several problems, including building entry, water entry, and air entry," he said.

"The longer it takes to find the damage, the more damage there will be," Logan concurred. "If nothing else, drive by and look for things that are out of place."

Also, if facility use is in flux or a long vacancy is expected, property owners should consider removing valuable materials and items such as copper, air conditioning units, heating and furnace units, electrical panels and boxes, and accessible wiring. Although this is a costly undertaking, it is less expensive than the alternative.

"Unlike when a vandal removes items, you can do it in a controlled condition that doesn't create additional damage," Shearman explained.

Logan urged insurers to perform adequate loss control surveys of vacant properties in this marketplace. Engineers should look for unsecured entry points, poor building maintenance, pre-existing damage, and deterioration of mechanical systems. They should detect evidence of trespassers and lack of routine checking by the building owner.

Shearman added that insurers' loss control staff should also assess control procedures around vacant properties, such as who will have access to the facility and what should happen when evidence of unauthorized entry occurs. In addition to making recommendations for new physical controls, such as perimeter fencing, risk engineers should advise property owners to put new procedures in place, such as enlisting the help of neighbors to watch the property. Vacant property owners should also be wary of people surveying a location under the guise of purchasing or leasing it.

"Make sure it's a legitimate consideration," he said. "Some people just survey a building to see what's available to steal or vandalize later."

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View the web seminar at **www.propertycasualty360.com/VacantProperties**