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INSURANCE BASICS FOR LANDLORDS AND TENANTS

Insurance clauses are one of the most intimidating and therefore neglected sets of provisions in a lease. There should be little gamesmanship in insurance provisions. Both landlord and tenants have an interest in drafting clear and accurate provisions to keep insurance costs low and to ensure that there is no overlapping coverage or gaps in coverage.

The following ten questions can serve as a guide to both landlords and tenants as they draft insurance provisions.

1. **What type of property insurance does landlord carry?**

The most common types of property insurance in use today are "fire and extended coverage," which insures against losses from 14 named perils, and "special form," which insures for all perils other than those which are specifically excluded. (Keep in mind that flood coverage and earthquake coverage are not considered part of special form insurance.) After identifying the property insurance that the landlord currently has in place, tenant attorneys should consider whether that coverage is adequate to rebuild the shopping center. The tenant should not necessarily, however, insist on the most expensive coverage possible since ultimately landlord's property insurance costs are paid by the tenants through CAM. The most commonly used forms in the property insurance industry are issued by Insurance Services Office, Inc. ("ISO").

2. **Is landlord insuring this asset separately or in a portfolio?**

Very few tenants ask a landlord which owns (or its affiliates own) multiple properties whether it carries insurance on a per property basis or in a portfolio. National and regional landlords usually insure their various locations as a portfolio. By combining properties in various regions of the country in a single portfolio, insureds can blend risk and save money overall. But tenants need to carefully consider whether landlord's division of its insurance costs throughout its portfolio is equitable.

3. **How much coverage does the insuring party have on the shopping center?**

Is the shopping center insured for full replacement value, or is the policy for an agreed value or actual cost value? Replacement value is the cost of replacing the damaged property. Agreed value is an amount agreed to be a value to satisfy the coinsurance provision and is paid for restoration without proof of costs to restore. Actual cash value is replacement cost less depreciation. If the damage is not restored, only actual cash value is paid by the insurance company. Depending upon bargaining power, the non-insuring party may want to require the insuring party to maintain commercially reasonable deductibles or other features to ensure that landlord will have sufficient funds to rebuild following a casualty. Of course, the more expensive the insurance that landlord is required to maintain, the higher the cost to tenants through insurance reimbursements. It is in both parties' interest to strike a reasonable balance between risk and cost.

4. Is landlord insured against catastrophic perils?

Understand that most property insurance policies (including special faun) do not insure against earthquakes or floods. Terrorism and windstorm coverage have separate sublimits and possibly separate deductibles even if not in a separate policy. Although these perils can impact properties not known to windstorm, coverage is critical in South Florida and the Gulf states, earthquake coverage in California, and flood insurance practically everywhere. If landlord refuses to be obligated to carry insurance against catastrophic perils relevant to the location of the property, tenant attorneys would be well advised to keep that in mind while negotiating provisions which deal with tenant obligations to re-open following a casualty.

5. What exactly has landlord insured?

Customarily, the owner of a shopping center maintains property insurance on at least the structural elements and common areas of the center, including parking lot, roof, walls, foundation, and demising walls. But custom is not always the rule. Both landlord and tenant attorneys need to understand the parameters of what landlord will be obligated to insure and, therefore, to rebuild. At a minimum, insurance proceeds must be made available to the party having the restoration obligation. Commercial property policies generally cover "Buildings" and "Building Personal Property." A "Building" is generally defined as a structure and includes: (1) completed additions; (2) fixtures; (3) permanently installed machinery and equipment; and (4) personal property owned by the named insured and used to maintain or service the Building. The tem' "Building" does not generally include: (1) land, water, growing crops or landscaping; (2) foundations of buildings, structures, machinery or boilers, if the foundations are below the lowest basement floor, or the surface of the ground, if there is no basement; (3) bridges, roadways, walks, patios, or other paved surfaces; (4) bulkheads, pilings, piers, wharves, or docks; (5) underground pipes, flues, or drains; (6) retaining walls not part of the building; and (7) cost of excavations, grading, backfilling, or filling. "Building Personal Property" refers to the personal property located within a building and out in the open within 100 feet of the building.

6. What kind of insurance should tenant be required to maintain?

Property insurance on tenant improvements is only one part of the myriad of coverages that a landlord may desire a tenant to maintain. Depending upon a tenant's use, landlord may require hazardous materials coverage or dram shop coverage. Some landlords require tenants to carry workers' compensation insurance and similar policies. Questions regarding the type of coverages and quantity of coverages should also be addressed with respect to tenant insurance.

7. Liability insurance -- how will the parties allocate the risk?

In shopping centers, a common risk allocation scenario is for landlords to provide liability insurance in the common areas and for tenants to provide liability insurance in the leased premises. This ensures no gaps or overlapping coverages. However, it is important to make sure that indemnification provisions work with this allocation of risk. There are different ways to structure indemnity provisions and clients (and attorneys) often balk at the idea of indemnifying one party for their own negligence. Remember that this is all about allocating risk and determining whose insurance company will pay a claim. In a fully-leased center with full

recoveries, tenants will be paying the entire cost of liability insurance anyway, so the regime should be as straightforward and cost-effective as possible. If the parties share responsibility as to sidewalks (e.g. tenant maintains sidewalk free and clear of snow, ice and rubbish and landlord otherwise maintains sidewalk) that leaves open what insurance policy is to handle a fall on the sidewalk unless the lease clearly states which party will insure what areas.

8. When is coverage triggered?

Determine whether landlord and tenant liability policies will be issued on an "occurrence" basis or a "claims made" basis. Each works as their names imply. If coverage is on an occurrence basis, then an incident is covered if it occurs during the policy period. If coverage is on a claims made basis, then an incident is covered only if the claim is made during the policy period.

9. What is the quality of the insurer?

In these uncertain economic times, it is more important than ever to understand the rating system employed to assess the health of insurance companies. The system most often used in lease forms is A.M. Best Company. The ratings issued by Best have two components. The alpha component (from A++ to F) is a qualitative and quantitative analysis of the insurer's financial condition. The numerical component (I through XV) represents the insurer's surplus and conditional reserve funds which are relevant to the financial size of the insurer. Visit www.ambest.com to check current ratings. Moody's (www.moody.com) and Standard and Poor's (www.standardandpoors.com) issue ratings using similar systems. Visit their websites to learn more and check current ratings.

10. How will evidence of insurance be provided?

A "certificate of insurance" is simply a document that shows that an insurance policy is (or was) in place. It is not the policy itself. There are different standard forms of certificates of insurance issued by the Association for Cooperative Operations Research and Development ("ACORD"), which each contain slightly different information. The ACORD 25 is evidence of liability insurance, not property insurance.

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