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Property Insurance Between Owners

Help clients understand whose policy coverage applies before and during sales transactions

AS COMMERCIAL MORTGAGE BROKERS ARE aware, buying and selling commercial real estate is a complex process. The timeline of a deal can be lengthy as brokers help guide property-buyers through the myriad legal and financial rules and regulations. Getting all the details right the first time saves everyone involved time and headaches down the road.

One of the many major details involved in commercial property purchases is the handling of insurance coverage and claim issues when a building transitions from the seller to the buyer. For brokers, it's important to have a general idea of what types of insurance-related concerns can arise.

There are a few general insurance-related areas to consider when helping your clients move forward with a transaction.

Midnight plus one

Timing can be everything when it comes to insurance. Consider the proverbial midnight rule regarding when one policy ends and another begins. Your clients must pay special attention to these timing details and be aware that most property and liability policies specify 12:01 a.m. as the start and end time for applicable policy periods.

As an example, if a property-insurance-policy period expires on April 22, the property-owner who decides to report an insurance claim "right after I eat lunch" on that date will be out of luck. This is because 12:01 a.m. would have already passed by lunchtime. In this case, April 21, would effectively be the last business day to turn in a claim on this policy.

Let's presume a sale was slated to close at 5 p.m. on April 22. The policy, as noted above, had expired at 12:01 a.m. that day — 17 hours before the closing. If the

property burned down at 4 p.m. on the closing date, the seller's insurance policy would not cover the damage from the fire. In this instance, it would be hoped that the buyer had insured the property as of the closing date.

Also, note whether the policy specifies an applicable time zone. If the insured policyholder or property is in a different time zone than stated in the policy, be aware of the difference — e.g., if a policy states 12:01 a.m. PST as the termination time, then the termination time is 3:01 a.m. EST for someone on the East Coast.

When policies overlap

Property-sellers and -buyers sometimes face situations where insurance coverage actually overlaps for a period of time during the closing process. In this scenario, who is responsible should damage occur? As with almost everything else involving insurance, the answer can be complicated.

In general, one of three following situations is possible:

- 1. The seller bears the risk of loss** until a specifically identified time, such as the time of closing, as stated in the purchase-and-sale documents. In this case, the seller's insurance would likely pay for any loss.
- 2. The buyer bears the risk** of loss after a specifically identified time, as stated in the purchase-and-sale documents. Here, the buyer's insurance likely would cover the loss.
- 3. The purchase-and-sale documents** are silent or unclear on this issue. In this case, each policy's "other insurance" clause likely would dictate the rules regarding which policy or policies would

respond to a claim. Other-insurance clauses spell out what happens if two or more policies apply to a loss. Based on the language of these clauses, one policy may pay as a primary insurer with the other policy assuming an excess, or secondary, position. In other cases, both policies may pay the loss in specified percentages or shares. For example, each insurer may split the cost equally.

Something new

Often, property-owners with a portfolio of properties simply want to add their new building to their existing policy, just as one might add a second car to an auto-insurance policy. There are some specific challenges of which property-buyers should be aware when adding a new building as a covered property on an existing insurance policy, however.

Depending on the building's size, use and relative risk, the challenge may be nonexistent or it may be complex. It is always best to approach an insurance broker well before adding a new property to an existing policy, however, as there may be

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time-consuming requirements the property-owner should address before the property is added.

Something old

Sometimes, a property-buyer may seek to obtain insurance coverage from the seller's policy. For example, if the buyer discovers water damage behind the building's siding a year after closing, and that damage happened during the time the seller owned the building, it may be possible to obtain an assignment of seller's rights to make a claim on the seller's insurance policy.

Whether this type of remedy would be available to a buyer facing that problem depends on numerous factors, some legal and some factual. Buyers facing this situation should certainly perform due diligence

on the availability of other insurance to pay for the loss.

Water damage is one of the most-common types of damage to commercial buildings. There are times when water damage can occur and perhaps go unnoticed for months or even years. Buyers and sellers may want to know if available insurance coverage will pay to fix water damage to the property's building envelope — i.e., the weather-tight system comprising roof, siding and windows.

The answer often is yes, a fact some insurance agents are hesitant to disclose. Although not all property-insurance policies have the same language, many provide coverage for, among other things, collapse damage, damage caused by certain weather conditions or even plain water damage.

And often, it is not the current policy insuring the property that has the responsibility to pay. Rather, the older policies that were in force when the damage was actually happening should cover the claim. It is therefore important that commercial property-owners maintain complete copies of all property-insurance policies, even the old ones.

Brokers who understand these and other property-insurance issues can help their clients when related questions arise. ●