Benchmark Insurance Requirements For Commercial Real Estate Loans, And Why They Say What They Say

James E. Branigan and Joshua Stein

Lenders typically regard a borrower's obligation to insure the mortgaged property as one of the most fundamental nonmonetary obligations under any set of loan documents. In this article, James E. Branigan, President and Chief Executive Officer of Omega Risk Management LLC, and Joshua Stein, a real estate and finance partner in Latham & Watkins LLP, offer a set of standard insurance requirements that any lender might reasonably seek to impose as part of its standard loan agreement or mortgage.

Real estate loans start from the fundamental assumption that the Borrower's building will continue to exist so it can continue to throw off rental income from which the Borrower can continue to pay debt service. A fire or other loss affecting the Borrower's building can undercut that very fundamental assumption and throw the loan into default rather quickly—unless the Borrower has maintained an appropriate package of insurance coverage for the mortgaged property.

Similarly, if the building burns down or suffers some other damage without appropriate insurance coverage, the Lender will find that the value of the mortgaged property will decline substantially and will probably not support repayment of the principal of the loan.

For those reasons, any Lender will typically regard the Borrower's obligation to insure the mortgaged property as one of the most fundamental nonmonetary obligations under any set of loan documents.

To try to define a reasonable benchmark for insurance requirements in any substantial commercial real estate loan, this article offers a set of standard insurance requirements that any Lender might reasonably seek to impose as part of its standard loan agreement or mortgage. These requirements are intended to be reasonably complete, thorough, and Lender-oriented, without being excessive. They approach insurance the same way that a prudent risk manager would, if that risk manager were trying to protect the mortgaged property and its cash flow in a manner consistent with typical expectations in the commercial real estate industry and lending community.

Extensive endnotes following this article explain why some of these provisions say what they say, other ways to approach particular issues, and some gaps that may still need to be filled for particular types of loan.

In addition to ''generic'' insurance requirements of the type this article offers, any set of loan documents for a substantial commercial loan will often need to

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contain insurance requirements that arise from particular characteristics of a particular building. These requirements might arise, for example, from particular occupancies, construction techniques, zoning issues, nearby risks, other special hazards, and the terms of particular major leases (particularly on rent loss or business interruption insurance and restoration). For any particular loan, a Lender's insurance personnel or outside consultant should identify and tailor these requirements as appropriate.

Expectations about insurance requirements vary widely. It often seems that every insurance expert has a different view about what any insurance program ''must'' include and whether a particular set of insurance provisions is ''adequate'' or ''seriously flawed.'' Any insurance expert can almost always suggest improvements in any insurance requirements or any insurance program. There is always something to add. Many of these suggestions—whether for modifications or additions—are often perfectly valid. Differences of opinion about insurance reflect the complexity and constantly changing nature of the insurance market.

The model insurance language offered here seeks to reflect recent developments in the law, the markets, and the world of insurance. This language is not specifically tailored for securitized loans or for any particular transaction. For any particular loan, and particularly one that will be securitized, this language must be checked against the specific circumstances of the mortgaged property and the current requirements and expectations of the rating agencies.

A few more comments about this article:

Future Changes. Insurance markets and Lenders' expectations change over time as the business world becomes aware of new risks or the magnitude of older risks previously thought insignificant. These sample insurance provisions seek to respond to the marketplace and Lenders' expectations at the time of writing, but will inevitably become out of date. The authors intend to maintain these insurance provisions as a current baseline taking into account the markets as they change. Updated versions will be distributed periodically to the authors' clients. Copies will also be distributed to others upon request.

Policy Boilerplate. The last few decades have seen numerous new theories of liability, each initiated by enterprising plaintiffs' lawyers (sometimes with help from ''public interest'' organizations) and usually followed by a gold rush of claims against insurance companies. Each such gold rush then produces new or improved exclusions from coverage in subsequent insurance policies—for example, the ''pollution exclusion'' and more recently new limits on coverage for ''toxic mold'' risks. Terrorism coverage followed a somewhat similar path, at least until federal legislation addressed the issue. Some of the latest new policy limitations are buried in the boilerplate of insurance policies. A Lender will often want to unearth and understand those limitations as part of the process of closing a loan. In some cases, the Lender can require the Borrower to pay an additional premium to solve the problem. That entire process falls outside the scope of this article, but will often be an important part of closing a Loan.

Rating Agency Requirements. The requirements of the rating agencies for any securitized loan will often change over time, so they must be checked regularly. For example, on May 1, 2003, based in part on difficulties in the insurance market, Standard & Poors lowered the required rating for property insurers to ''A,'' thus matching the requirement for liability carriers. At the same time, Standard & Poors made other changes in its requirements for insurance coverage.

References to Rating Agencies. Wherever this model language refers to the Rating Agencies, that reference can usually be omitted for portfolio loans, but only after confirming that some other appropriate requirement is added (or already exists) to assure that the matter in question will satisfy the particular Lender's requirements.

Best's Ratings. This article requires that insurance carriers have an A.M. Best rating of at least ''A:X.'' The first letter refers to the ''quality'' of the company and can range from A++ (the highest) all the way through F (in liquidation) and S (suspended). The second letter refers to the ''financial size category'' (''FSC'') of the company, a combination of its capital, surplus, and ''conditional reserve.'' FSC requirements should take into account a particular company's potential exposure to loss. FSC ratings can range from I ($10 million FSC) to XV (over $2 billion FSC). Typically a Lender will require a rating of at least A:X (i.e., FSC of at least $500 to $750 million and quality level of ''Excellent''), but may accept a smaller company for a smaller exposure. As an example, risks like earthquake and windstorm coverage are difficult to place and relatively little coverage can usually be obtained. Many Lenders would settle for smaller companies for these risks (but would not reduce their ''quality'' standards).

Construction. This article includes very limited requirements for Builder's Risk Insurance. This language is designed only for incidental additions to buildings, and perhaps limited renovations of existing structures. If a Borrower undertakes substantial construction, or for any construction loan, the construction-related insurance requirements in this sample language will not suffice. Instead, a comprehensive construction-related insurance program will usually need to be designed, taking into account whatever insurance the contractors and subcontractors already bring to the table. Because the Borrower ultimately pays for all parties' insurance, the Borrower (and any Lender concerned about the budget, i.e., any Lender) will often want to wrap all insurance for any large project into a single policy, a so-called ''controlled insurance program'' or ''CIP.'' This ''CIP'' structure will often cost less than many separate but overlapping policies provided by many separate parties. A single

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policy can also simplify the processing of any insurance claims. The insurance process for any construction job will also often include a coordinated bonding program for the project. Again, the entire topic is outside the scope of this article.

''Claims Made'' Policies. For a while, the insurance industry tried to convince its customers to accept ''claims made'' policies, where the carrier agreed to cover only whatever claims were actually made during the life of the policy. Such policies are quite unattractive to the insured, and have generally fallen into disuse, except in two areas: environmental risk insurance and professional liability insurance. A typical real estate Lender will not accept ''claims made'' coverage.

Coverage Levels. The minimum coverage requirements in this article are provided for illustrative purposes only, and based on ''typical'' requirements of many Lenders. Minimum coverage requirements for any particular mortgaged property can be determined only after careful analysis of the risks associated with that particular mortgaged property.

Use of Model Documents. Like every other sample legal document, this one can either be used for a specific transaction or as a reference for comparison. In any case, this sample insurance language should not be used without appropriate legal and insurance advice tailored to the particular mortgaged property, the particular loan, and applicable law.

Benchmark Insurance Requirements

Until Borrower has fully paid and performed all Obligations and Lender has released or assigned the Security Documents, Borrower shall at all times maintain the following insurance policies and comply with the following obligations (such policies and compliance, collectively, the ''Required Insurance''):

1.1. *Special Perils Insurance.* Borrower shall maintain property insurance against all risks of loss to the Mortgaged Property customarily covered by so-called ''All Risk'' or ''Special Perils Form''[1] policies as available in the insurance market as of the Closing Date (collectively, the ''Special Perils Insurance''[2]). Special Perils Insurance shall cover at least the following perils: fire, lightning, flood, water damage, impact of vehicles and aircraft, tsunami, mudslide, subsidence, terrorism, building collapse, windstorm, hurricane, vandalism, and malicious mischief. Special Perils Insurance shall also cover such other insurable perils as, under good insurance practices, other commercial property owners from time to time insure against for property and buildings similar to the Mortgaged Property in nature, use, location, height, and type of construction, as evidenced by written advice from Lender's insurance advisor (''Comparable Properties''). Each Special Perils Insurance policy shall cover: (a) additional expense of demolition and increased cost of construction,[3] including increased costs that arise from any changes in Laws regulating any Restoration; (b) at least 100% of the replacement cost value[4] of the Improvements[5]; (b) and (c) all tenant improvements and betterments that any Lease requires Borrower to insure. Any Special Perils Insurance policy shall contain an agreed amount endorsement[6] or a coinsurance waiver and replacement cost value endorsement[7] without reduction for depreciation. If Borrower's Special Perils Insurance does not otherwise cover damage caused by the acts of terrorists,[8] then Borrower shall provide such coverage under a separate policy that complies with all requirements that would apply to Special Perils Insurance.[9]

1.2. *Flood Insurance.* If any Improvements are located in an area designated as ''flood prone'' or a ''special flood hazard area'' under the regulations for the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, Borrower shall maintain at least the maximum coverage[10] for the Mortgaged Property available under the federal flood insurance plan. Lender may require additional flood insurance coverage, including related Rent Loss Insurance. Any insurance this paragraph requires is referred to as ''Flood Insurance.''

1.3. *Earthquake Insurance.*[11] Borrower shall maintain earthquake insurance in any area of increased risk as Lender or the Rating Agencies require (the ''Earthquake Insurance''). Lender may change its requirements for Earthquake Insurance from time to time based on: (a) review of a current probable maximum loss seismic study, to be prepared at Borrower's expense, forecasting the expected damage from any event anticipated to reoccur once in 475 years, on a 90%-certain statistical basis; (b) actual and potential losses at any other locations the same Earthquake Insurance covers and sharing the policy's occurrence and annual aggregate limits of available coverage; and (c) the amount of lost business or rental income to be expected during Restoration. Deductibles shall be satisfactory to Lender, but never more than 5% of the location insurable values.[12]

1.4. *Boiler and Machinery Insurance.* Borrower shall maintain comprehensive boiler and machinery insurance covering all mechanical and electrical equipment against physical damage, rent loss, extra expense, and expediting expense covering Borrower's property and any tenant improvements and betterments that any Lease requires Borrower to insure (the ''Boiler and Machinery Insurance''[13]). Borrower shall provide Boiler and Machinery Insurance on a replacement cost value basis. For each accident, Borrower's Boiler and Machinery Insurance shall cover at least the greater of: (a) 15% of full replacement cost of the Improvements; and (b) $500,000.

1.5. *Builder's Risk Insurance.*[14] During any Construction, Borrower shall maintain builder's risk insurance for not less than the full completed project insurable value of the building in which the Construction is then being performed, covering the same risks and otherwise complying with the same requirements as

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Special Perils Insurance, to such limits and with such coverage extensions as Lender may require (the ''Builder's Risk Insurance''), except to the extent included in Borrower's Special Perils Insurance. Any Builder's Risk Insurance shall be written on a ''completed value'' form[15] (100% non-reporting) or its equivalent and shall include an endorsement granting permission to occupy.[16] Builder's Risk Insurance shall cover: (a) the same perils that Special Perils Insurance must cover; (b) loss of materials, equipment, machinery, and supplies whether on-site, in transit, or stored off-site, or of any temporary structures, hoists, sidewalks, retaining walls, and underground property; (c) soft costs, plans, specifications, blueprints and models; (d) demolition and increased cost of construction,[17] including increased costs arising from changes in Laws at the time of Restoration and coverage for operation of building Laws, all subject to a sublimit satisfactory to Lender; and (e) rental interruption[18] (delayed opening) on an actual loss sustained basis and otherwise in compliance with the requirements for Rent Loss Insurance.

1.6. *Rent Loss Insurance.* As an extension to its Special Perils Insurance, Flood Insurance, Earthquake Insurance, Boiler and Machinery Insurance, and Builder's Risk Insurance, Borrower shall maintain rent loss insurance[19] on an ''actual loss sustained'' basis (the ''Rent Loss Insurance''). (''Property Insurance'' refers to all forms of insurance mentioned in the previous sentence.) Borrower shall maintain Rent Loss Insurance in an amount equal to at least 12 months of Borrower's actual gross revenue of the Mortgaged Property, including percentage rent, escalations, and all other sums payable by Tenants under Leases or otherwise derived from Borrower's operation of the Mortgaged Property. (On and after the date of any Securitization, ''12 months'' shall be replaced by ''18 months.'') In addition, Rent Loss Insurance shall be endorsed to include an extended period of indemnity[20] of 180 or 360 days, as Lender shall require from time to time.

1.7. *Liability Insurance.*[21] Borrower shall maintain the following insurance for personal injury, bodily injury, death, accident and property damage (collectively, the ''Liability Insurance''): (a) public liability insurance, including commercial general liability insurance[22]; (b) owned (if any), hired, and non-owned automobile liability insurance[23]; and (c) umbrella liability insurance.[24] Liability Insurance shall provide coverage of at least $____ million per occurrence and $____ million in the annual aggregate,[25] per location.[26] If any Liability Insurance also covers other location(s) with an aggregate limit, then the minimum Liability Insurance shall be increased to $____ million.[27] Liability Insurance shall include coverage for liability arising from premises and operations, elevators, escalators, independent contractors, contractual liability (including liability assumed under Contracts and Leases[28]), and products and completed operations. All Liability Insurance shall name Lender as an ''Additional Insured''[29] by an endorsement satisfactory to Lender.

1.8. *Statutory Employees' Insurance.* Borrower shall maintain workers' compensation and disability insurance as Law requires (''Statutory Employees' Insurance'').

1.9. *Environmental Insurance.*[30] Borrower shall maintain environmental insurance covering unknown environmental hazards as of the Closing Date (the ''Environmental Insurance'') in an amount not less than $____ per discovery. Such coverage shall identify Lender as an ''Additional Named Insured'' through an endorsement satisfactory to Lender. The carrier shall agree that the policy shall be automatically assigned to Lender, with no further action required by any Person, if: (a) control of the Mortgaged Property passes to Lender or its designee as the result of an Event of Default or any exercise of Lender's Remedies; or (b) Lender or its insurance advisor otherwise at any time so requires.[31]

1.10. *Other Insurance.* Borrower shall maintain such other types and amounts of insurance for the Mortgaged Property and its operations as Lender or the Rating Agencies shall from time to time require, consistent with insurance commonly maintained for Comparable Properties. Wherever any Required Insurance specifies any dollar amount, Lender may increase that dollar amount periodically to reflect Lender's reasonable estimate of inflation.

1.11. *Documentation.* Borrower shall cause Lender to be named as ''Lender Loss Payee'' or ''Mortgagee'' on a standard noncontributory mortgagee endorsement or its equivalent, in either case satisfactory to Lender, for all Property Insurance. Each such endorsement shall name Lender (or such party as Lender may designate) as the party to which the carrier shall pay any Insurance Proceeds.

1.12. *Policy Requirements.*[32] Borrower shall secure all Required Insurance from domestic insurer(s) authorized to do business in the State and reasonably satisfactory to Lender with: (a) a claims paying ability of not less than ''AA'' (or the equivalent) by S&P and one other Rating Agency satisfactory to Lender; and (b) ''A:X'' or better financial strength rating by AM Best.[33] Borrower shall obtain Lender's reasonable approval of the form, substance, amounts, risk coverage, sublimits, deductibles, loss payees, and insureds for all Required Insurance. Required Insurance shall contain such provisions as Lender deems reasonably necessary or desirable to protect its interest, including endorsements stating that neither Borrower, Lender, nor any other party shall be deemed a co-insurer. Borrower shall pay the premiums for all Required Insurance when due and payable. Borrower shall not finance insurance premiums under any arrangement that could (if any premium loan payment is not made) result in the premature cancellation of any Required Insurance.[34] Borrower shall deliver to Lender, im-

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mediately upon issuance, copies of the insurance policies for all Required Insurance, certified as true and complete by the carrier or its authorized representative. At least 30 days before any policy expires, Borrower shall deliver evidence of renewal in compliance with the Loan Documents. If Borrower fails to do so by such date, then without limiting Lender's Remedies, Lender may (but shall have absolutely no obligation to) force place any Required Insurance. Lender's cost of doing so shall constitute a Protective Advance.

1.13. *Blanket Coverage.* Borrower may provide any Required Insurance under a blanket policy or policies covering the Mortgaged Property and other property and assets not part of the Mortgaged Property, provided that any such blanket policy: (a) otherwise complies with the requirements for Required Insurance; and (b) except in the case of Liability Insurance, specifies how much coverage, and which sublimits, apply exclusively to the Mortgaged Property. Such allocated coverage shall equal or exceed the Required Insurance.

1.14. *Protection of Lender's Interest.* In each insurance policy (or an endorsement thereto), the carrier shall: (a) agree not to cancel, terminate, or nonrenew such policy without giving Lender 30 days prior written notice (10 days notice for nonpayment of premium); (b) agree not to change the deductible, coverage limit(s), or other term(s) of such policy, if the policy would thereafter cease to comply with this Agreement; (c) waive any right to claim any premiums and commissions against Lender, provided that the policy need not waive the requirement that the premium be paid in order for a claim to be paid to the insured; and (d) allow Lender to pay premiums to continue such policy upon notice of cancellation for nonpayment. If Lender pays any such premiums, then such payments shall constitute Protective Advances. Every Property Insurance policy shall provide that as to Lender's interest, such policy shall remain valid and shall insure Lender regardless of any: (a) named insured's act,[35] failure to act, negligence, or violation of warranties, declarations, or conditions; (b) occupancy or use of the Mortgaged Property for purposes more hazardous than those permitted; or (c) Lender's exercise of any Lender's Remedies.

1.15. *No Separate Insurance.* Borrower shall not carry separate insurance,[36] concurrent in kind or form or contributing in the event of Loss, with any Required Insurance. Borrower may, however, carry insurance for the Mortgaged Property, in addition to Required Insurance, but only if such additional insurance: (a) does not violate or entitle the carrier to assert any defense or disclaim any primary coverage under any Required Insurance; (b) mutually benefits Borrower and Lender, as their interests may appear; and (c) otherwise complies with this Agreement.

1.16. *Lender's Rights; No Liability.* Notwithstanding anything to the contrary in any Loan Document, if at any time Lender has not received satisfactory written evidence that Borrower maintains all Required Insurance in full force and effect in full compliance with this Agreement and has paid all required premiums, then Lender may at its option take such action as Lender deems necessary to protect Lender's interests, including obtaining such insurance coverage(s) as Lender shall deem appropriate. Lender's expenses in doing so, and any other expenses or losses that Lender suffers or incurs as a result of Borrower's failure to perform any obligation regarding Required Insurance, shall constitute Protective Advances. Borrower irrevocably authorizes Lender, at any time, to communicate directly with Borrower's insurance carrier(s), broker(s), and Tenant(s) regarding any Required Insurance. Borrower shall promptly upon demand deliver to Lender further written authorizations addressed to such Persons, and authorizes and directs all such Persons to communicate directly with Lender at Lender's request. Any direct communications by Lender shall not: (a) impose any obligation or liability on Lender; or (b) entitle Borrower to any defense, offset, or counterclaim against the Obligations. If at any time Lender makes any determination or request regarding the amount, scope, or terms of any Required Insurance, any such determination or request shall impose no obligation or liability on Lender. Borrower shall not rely upon any such determination or request. Borrower acknowledges that any such determination or request would be made solely for Lender's own benefit and not for Borrower's benefit. Borrower shall retain sole responsibility for the adequacy and appropriateness of its insurance program without relying on Lender.

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[1] Property owners can generally buy three possible levels of property insurance coverage: (1) ''basic,'' which covers fire and lightning; (2) ''broad,'' which includes fire and extended coverage (named perils), covering a substantial list of additional hazards; and (3) ''special,'' which provides coverage for risk of loss from all sources except a few specifically listed hazards. The last category, the broadest of the three, represents the established term for what was once called ''all risk'' coverage.

[2] Property Insurance is called ''first party'' coverage, because any claims are paid solely to the policy holder—typically the Borrower but also the Lender if properly endorsed onto the policy. In contrast, ''third party'' coverage protects the insured from the possible obligation to pay losses and damages due and payable to injured third parties. The latter coverage is sometimes called ''casualty'' coverage, a term often erroneously applied to Property Insurance. To avoid confusion, it is advisable not to use the word ''casualty'' for any insurance. In all cases, the ''second'' party is the insurance carrier, the company that issued the policy.

[3] Demolition and increased cost of construction coverage, also known as ''Law and Ordinance'' coverage, is actually an endorsement (addition) to a Special Perils Insurance policy. After a loss, this endorsement extends the policy to cover any additional cost of reconstruction the Borrower incurs from enforcement of a law or building ordinance that requires the building to be constructed to a higher standard

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after the loss than before. As an example, before a loss an older building might not have needed to comply with modern sprinkler requirements or the Americans With Disabilities Act. After the loss, when the Borrower rebuilds, the building must meet both requirements, thus increasing the cost to rebuild. These endorsements cover that extra cost, usually subject to a sublimit.

[4] ''Replacement cost value'' is the amount necessary to reconstruct the building on the same site for the same use with similar materials. Replacement cost value includes building improvements to the land. It does not, however, include the market value of the building or the cost of the land.

[5] ''Law and ordinance coverage'' does not cover any loss the Borrower suffers if current zoning laws are more restrictive than those when the building was built, to a point where the Borrower cannot restore the damaged building to the same size that existed before the loss (the ''legal nonconforming use'' problem). In that case, typical Special Perils Insurance will pay: (a) replacement cost to rebuild the building at the same location, to the extent it can be rebuilt there; and (b) only ''actual cash value'' for the part of the building that could not be rebuilt. Unfortunately, ''actual cash value'' reflects deductions for depreciation, obsolescence, and other factors. In the worst case, the insurance award might not cover the loan amount. Depending on the condition of the insurance market, Borrowers, Lenders, and their advisers may nevertheless be able to tailor special insurance coverage for the resulting ''loss of economic value'' (and corresponding insurance requirements in the loan documents) to make the Lender whole under these circumstances. The disposition of the Insurance Proceeds from a major loss affecting such a building then becomes an issue between the Borrower and the Lender.

[6] After a loss, an insurance carrier may impose ''coinsurance'' adjustments to punish a property owner that underreported the insurable value of its property. For example, if the true replacement cost value of the mortgaged property is $100 and the owner insures it for $50, this represents a 50% level of underinsurance. The insurance carrier was being shortchanged by 50% of the premiums it should have received for bearing the full risk of all possible Losses that might affect the building (anywhere from 1% to 100% of the insurable value of the building). The insurance carrier will therefore reduce any Insurance Proceeds by the same percentage. Under these facts, if the mortgaged property suffers a $30 loss, the carrier will pay only $15 (a 50% reduction corresponding to a 50% failure to insure). In an ''agreed amount endorsement,'' the insurance carrier waives its right to make this adjustment. Instead, it confirms that it agrees with the Borrower's valuation. These endorsements can apply to Special Perils Insurance and Rent Loss Insurance.

[7] The use of ''replacement cost value'' is preferable to ''actual cash value'' (valuation clause). ''Actual cash value'' deducts some percentage from any Property Insurance proceeds for depreciation and obsolescence of the mortgaged property, whereas ''replacement cost value'' does not.

[8] Coverage for the acts of terrorists does not include coverage for any damage caused by war. Losses caused by war are not currently insurable. Historically, the federal government has issued war insurance during certain periods of hostilities.

[9] The preceding sentence and others like it in other documents provide brief reminders of the insurance markets in 2001 and 2002, when terrorism insurance was virtually unobtainable but that did not stop some servicers from requiring it, regardless of cost or cost-benefit ratio. During that moment in history, numerous seminars were held on terrorism insurance, newspapers covered terrorism insurance litigation on the front page, courts disregarded prior principles stating that injunctions could not be issued in disputes that merely related to (non)payment of money, and the issue of terrorism insurance often dwarfed all other issues in loan document negotiations. Though Borrowers and Lenders often negotiated all night to do it, they usually agreed on compromise measures such as the following, or some subset of the following: ''Notwithstanding anything to the contrary in the Loan Documents, Borrower shall be required to provide terrorism insurance only to the extent that: (a) by expending no more than $____ per year in incremental insurance premiums, Borrower can obtain terrorism insurance coverage of at least $____ per insured loss; (b) at the time in question, [institutional] [prudent] [reputable] owners of Comparable Properties are in fact purchasing and maintaining terrorism insurance; and (c) terrorism insurance is commercially available through ordinary insurance markets upon paying premiums that are commercially reasonable under the circumstances.'' Although terrorism insurance seems, at least for now, to have joined ''The Y2K Crisis'' in the history books of commercial real estate financing, some Borrowers and Lenders continue to agree to protective language on the subject.

[10] The National Flood Insurance Plan can cover flood losses of up to $500,000 per commercial building (plus $500,000 for the contents of each building), but not loss of business income or rental income. Losses are paid on an actual cash value basis. Private carriers can and do issue additional flood insurance. Many Lenders require it.

[11] The scope of Earthquake Insurance can vary, depending on how the policy defines ''earthquake.'' It may and may not include mud slides, sinkholes, general earth movement, and even water-saturated land.

[12] For a securitized loan, deductibles beyond 5% of annual net cash flow may require corresponding reserves to cover the Borrower's exposure.

[13] Boiler and Machinery Insurance isn't really just boiler and machinery insurance. It covers: (a) the explosion of boilers and pressure vessels (no surprise); (b) any mechanical and electrical breakdown of machinery and equipment in a building (essentially any building system—going far beyond boilers and pressure vessels); and (c) any damage or loss that results from an insured event.

[14] Special Perils Insurance does not usually cover losses that result during significant construction work on a building, because the level and mixture of risks during construction is so different from (and usually higher than) the level and mixture of risks in a completed building in operation. During major construction, a building owner plugs that insurance gap by obtaining Builder's Risk Insurance, covering the higher/different exposure to loss during construction. Builder's Risk Insurance covers the owner's and the contractors' interests in materials installed into the structure and (if properly endorsed) in materials in transit or stored off site. Coverage can be extended to cover ''soft costs'' (i.e., incremental debt service expense, incremental architecture and engineering expenses, permits, and expenses not directly related to construction but that the owner incurs to reconstruct

the building). This coverage can also cover a delayed opening because of a loss that occurs during construction and would otherwise delay the planned completion date of the project. For substantial construction projects, the structuring of Property Insurance and Liability Insurance is a science to itself, in which a careful owner can dramatically reduce its costs by avoiding duplication and consolidating all coverage in one place. The sample insurance provisions offered here are not designed for a construction loan.

[15] A ''reporting form'' requires monthly reporting of values, thus creating opportunities for error and a possible risk of coinsurance. Borrowers and Lenders usually favor a ''Completed Value Form,'' which eliminates the reporting requirement and instead bases the insurance coverage on the value of the project as completed.

[16] Without this endorsement, if the Borrower finishes construction and allows occupancy of the building, this may impair the insurance coverage.

[17] This extra coverage is discussed above, in the context of Special Perils Insurance.

[18] A rental interruption endorsement to Builder's Risk Insurance adds Rent Loss Insurance to the package of Builder's Risk Insurance coverages.

[19] For investor-owned commercial real estate, Rent Loss Insurance covers the Borrower's loss of rental income, and the need to continue paying fixed expenses even while the Mortgaged Property is out of operation, up to the coverage limits. Rent Loss Insurance helps the Borrower only to the extent that leases excuse tenants from paying rent after casualty. If the leases don't abate rent after casualty and instead the tenants just refuse to pay, Rent Loss Insurance won't help. This is why it is often in the Borrower's (and the Lender's) interest for leases to abate rent after a casualty. Of course, the abatement must mesh correctly with the Borrower's Rent Loss Insurance. This coverage will pay (up to the coverage limits) during a recovery period starting on the date of the Loss and continuing until the time when, with ''due diligence and dispatch,'' the Mortgaged Property can be restored to its condition before Loss. If the Borrower owns, instead of leases, the Mortgaged Property, then the documents would instead require the Borrower to maintain ''business interruption insurance,'' which raises comparable issues.

[20] An ''extended period of indemnity'' extends Rent Loss Insurance beyond the date when payments would otherwise end, i.e., the date when the Improvements are restored to their condition before the Loss. The extension continue the insurance payments for an additional period—up to the specified maximum—to give the Borrower more time to bring rental income back to its level before the Loss occurred. This can smooth out lost cash flow after a Loss.

[21] Liability insurance is third-party coverage, protecting the insured (the first party) from loss from ''tort'' liability to third parties. In general, ''tort'' means damage or injury that one party causes another absent a contractual relationship. For example, a car crash creates ''tort'' liability. So might a banana peel on which someone slips and falls.

[22] The commercial general liability policy is the most widely used form for liability coverage. Loan documents still often refer to the ''comprehensive form,'' which was issued in 1972 and required major modification to be tolerable to Lenders. It is still occasionally seen, but should be avoided. The ''commercial form'' of liability insurance policy is broader and does not suffer from the problems of the ''comprehensive form.'' All coverage under general liability insurance is limited to bodily injury, property damage, and death.

[23] Any commercial general liability policy typically excludes any coverage for automobile liability. Therefore, it has become common practice to require this coverage as a separate and additional item.

[24] ''Umbrella'' liability insurance provides coverage going beyond the ''primary'' liability coverage. In effect, it sits on top of the insured's basic liability coverage package: commercial general liability insurance, automobile liability insurance, and the employer's liability part of a workers' compensation policy. Umbrella liability insurance is usually a bit broader than the underlying coverages, considered as a whole. In contrast, ''excess'' liability coverage merely increases the dollar amount of component(s) of the underlying liability coverage. An insured (and a typical Lender) will usually prefer ''umbrella'' over ''excess'' liability coverage.

[25] Limits of liability coverage should be set high enough so they are reasonably able to cover the worst loss that the Lender and its advisors think has some reasonable likelihood of occurring, taking into account the risks, size, use, occupancy, and location of the mortgaged property. In today's world, any commercial property should rarely carry coverage of less than $5,000,000 to $10,000,000. A substantial property should carry at least $10,000,000 to $25,000,000. A very large or trophy property should carry anywhere from $30,000,000 on up. These limits always depend very much on the specific circumstances of a particular project.

[26] Commercial general liability and umbrella liability insurance contain annual policy aggregates. For multiple-location (''blanket'') insurance policies, these aggregates can and should be extended to apply on a per location basis.

[27] If the borrowing group wants to share aggregate limits of insurance among many locations, the Lender should require higher limits, because of the possibility of multiple large losses across the portfolio.

[28] An insured often enters into contracts (such as leases, management contracts, and service contracts) in which the insured agrees to indemnify third parties against losses that would be covered by the insured's Liability Insurance, i.e., property damage, bodily injury, and death to third parties caused by the insured (or certain other persons). To assure that Liability Insurance will cover those indemnity obligations, the insured will typically obtain ''Contractual Liability'' coverage in its Liability Insurance package. With that extra coverage—which is not automatic—the insured's Liability Insurance covers indemnity obligations arising under only certain ''Insured Contracts,'' as defined in the insurance policy. Any ''disconnect'' between the policy language and the Borrower's contractual indemnity obligations can produce unpleasant surprises.

[29] By becoming an ''Additional Insured'' under the Borrower's Liability Insurance, the Lender protects itself against ''vicarious liability''—liability it might indirectly suffer as a result of acts and omissions of the Borrower for which the Lender can somehow be indirectly or partially blamed. The importance of this coverage cannot be overstated in today's world of ever-wider liability of parties that one might have thought to be ''passive'' and ''innocent'' a few decades ago. ''Additional Insured'' status does not protect the Lender from liability arising directly from its own acts or omissions.

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The Lender must protect itself from the latter liability through its own policy of liability insurance (or a self-insurance program). A Lender is not entitled to ''Additional Insured'' status on the Borrower's policy automatically, but must instead obtain an appropriate endorsement or other document.

[30] Environmental Insurance can provide both First Party and Third Party coverage for the Mortgaged Property. Environmental Insurance varies widely, depending on the specific circumstances of the specific site. This coverage is usually written on a ''claims made'' basis, for some multiple of $1 million in coverage. It may cover clean-up costs both on and off the site. Virtually every Environmental Insurance policy must be tailored to reflect known environmental conditions (if any) at the site and other unique circumstances. This task requires cooperation among the Lender's environmental, risk management, and insurance advisors. Because of the potential complexity and site-specific nature of this coverage, where it is needed it may be one of the longest lead time items for the closing.

[31] These requirements are not adequate for any Project that contemplates remediation. For any such Project, the clean-up contractor should at a minimum provide special coverage for environmental remediation, naming the Borrower and the Lender as additional insureds. The Borrower and the Lender may both also want coverage that assures them the cost of remediation will not exceed a certain dollar figure, so-called ''Cap Cost Insurance.'' Any environmental coverage must be tailored for a specific Project and specific remediation plan.

[32] Policy requirements should also reflect the Lender's guidelines and those of the Rating Agencies, if applicable.

[33] In May 2003, Standard & Poors reduced to ''A'' the minimum required rating for a Property Insurance carrier in securitized transactions.

[34] Borrowers often propose to finance their annual insurance premium. They borrow the premium at the beginning of the policy term, then repay it over the next eight to ten months with interest. If the policyholder (Borrower) misses a payment, the premium finance company can, and usually does, exercise its right to cancel the insurance policy. In accordance with the Standard Mortgagee Endorsement, the insurance carrier must then notify the Lender that the policy is being cancelled. Many Lenders regard this mechanism as unacceptable.

[35] The Standard Mortgagee Endorsement and Lender's Loss Payable Endorsement may protect the Lender from certain potential ''bad acts'' by the insured.

[36] Nearly all insurance policies contain an ''other insurance'' clause that precludes recovery if another policy covers the same risk. In other words, if a carrier can find another carrier to bear the loss, then the first carrier will decline to cover it. This exercise in finger-pointing can produce a mess if a Loss ever occurs, to the point where the insured might have had better coverage by buying less coverage. To avoid the problem, the insured Borrower should obtain the first carrier's permission to maintain the second policy, in which case the first carrier agrees not to try to make the second carrier the ''bagholder'' after a Loss. In any multi-policy insurance program, the Borrower will need to obtain this permission for all underlying insurance, excess insurance, and participating insurance. When a Lender reviews the Borrower's insurance program, the Lender must confirm that multiple carriers have appropriately recognized one another's positions, to prevent unexpected disputes among carriers (and even a denial of coverage) if a Loss occurs.

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