Reviewing Insurance

From A Lease Administrator's Perspective

by Rick Burke, Lease Administration Solutions, LLC

Editor's Note: Rick will be presenting a course on this subject at this year's NRTA Annual Conference: September 26-29, 2010 at the Anaheim Marriott Hotel.

OK. Smack in the middle of your CAM or Operating Expense statement is an enormous amount for insurance. You immediately get that sick feeling in your stomach because you've been here before and you know that insurance is so complicated that overcharges could be lurking anywhere.

Understanding insurance from a lease administrator's perspective differs from understanding insurance from a broker or a deal maker's perspective. Consequently, we have developed a 4-step process to aid in reviewing landlord's insurance that we call the TEDA rule. This rule encompasses the basics for reviewing insurance and should be understood by any lease administrator reviewing landlord billed insurance. TEDA stands for:

Types: Understand the types of insurance billed by landlord
Exclusions: Determine what insurance is excluded per the lease
Deductible: Verify deductible amounts
Allocation: Understand how the insurance is allocated (across landlord properties, shopping center, and tenant)

Of course, each of these steps can lead you down a path of new questions, but these comprise the starting point to a good review. **The letter T of our TEDA rule is for the Types of insurance that are often found in a landlord billing.** It is important to realize that certain insurance such as General Liability are predominately for the common area. The definitions of frequent types of insurance billed by landlords are as follows:

General Liability–A form of insurance coverage for an insured when negligent acts and/or omissions result in bodily injury and/or property damage on the premises of a business, or when someone is injured in the general operation of a business.

Property–Insurance that provides protection against most risks to property, such as fire, theft and some weather damage.

Umbrella–A form of additional insurance protection against losses in excess of the insurance coverage already in place.

Boiler and Machinery–Coverage for loss from the operation of pressure, mechanical and electrical equipment, boiler and machinery. Also may include damage done to other property, as well as business interruption losses.

Earthquake–Insures against earthquake damage.

Flood–Insures against flood damage.

Worker Compensation–Insures workers get compensated if injured on the job.

Renter Liability–Insurance coverage protecting the building owners against the loss of income when rentals have been interrupted or rental value has been impaired by the occurrence of any of the insured perils.

Business interruption–A type of insurance that protects the business from losses due to inability to operate because of fire or other hazards.

Environmental–A form of insurance designed to cover losses and liabilities arising from damage to property caused by hazardous material or pollution.

Terror–Insures against acts of terrorism to the property.

To get the types of insurance billed from the landlord, it is pertinent to get the correct supporting documentation. Often when we ask for insurance documentation we get either a spreadsheet from the landlord or a one page letter from the landlord's insurance agent. The tenant should not accept the landlord's spreadsheet because it is not source documentation. In addition, the insurance agent works for and is paid by the landlord, so information may not be independent. The tenant needs to obtain the **Insurance Declaration Page and Schedule of Premiums** from the landlord to truly substantiate the insurance cost. The Insurance Declaration Page will give you the types of insurance the landlord is providing and the Schedule of Premiums detailing the insurance cost and insured amounts associated with each property. Once you know what types of insurance the landlord is billing, you can then compare it to what the lease states the tenant is responsible for.

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Our next step is E which stands for Exclusions. This is where the lease is reviewed to understand what insurances the tenant should be paying. To do this, you need to read both the insurance and common area sections of the lease. In the common area section, we are looking for what types of insurance may be excluded, and if the insurance is for the common area or the entire shopping center or building. Does the lease address a portion of the property that the tenant is not responsible for, such as a parking deck, out parcel, or undeveloped land? We are also looking to see if landlord can apply an administrative fee on the insurance portion. Does the lease exclude insurance that is over and above the basic insurance needs of the property and can be considered part of the owner's overhead such as renter's insurance, business interruption, environmental, or terror?

From the insurance section of the lease we want to know who is responsible for insuring the building and HVAC. Often, larger tenants and tenants in stand-alone buildings may insure their own building. If this is the case, there is a good chance that the landlord may be insuring it as well, and passing it through to the tenant, thus the tenant is paying for it twice. In addition, if the tenant is insuring its own building, it should only be paying for insurance for the common area unless the lease states otherwise.

The D is to confirm landlords' deductibles. Much like your health insurance, the deductible is the amount the landlord has to pay before the insurance kicks in. The landlord is allowed to pass this cost through; unfortunately it needs to be verified like any other expense. The deductible expense may appear in the insurance, general and administrative, or miscellaneous accounts in the general ledger. A sample of these deductibles should be taken and a request for supporting documentation is needed to substantiate. Often the reviewer finds out about deductibles because the insurance per the Declaration Page does not match what the landlord is billing. Landlord deductibles should be based on an actual amount, not a projected amount that the landlord believes it will spend for deductibles over a course of time.

The final letter is A for allocation. Again we turn to our Insurance Declaration Page and Schedule of Premiums to calculate how much our shopping center is being charged for insurance and determine if the landlord is allocating this amount to the shopping center properly. This is where the landlord or the insurance agent may reallocate the insurance from the Insurance Declaration Page based on the preferences of the landlord. As we do not have the right to audit other properties, the only way to determine if the allocation of a blanket policy is fair is to compare the landlord billing to the Declaration Page and Schedule of Premiums. Often we find that the landlord is allocating less to properties with gross leases and/or properties occupied by the landlord. In essence, we want to confirm that the total amount from the Insurance Declaration Page is being allocated properly across landlord's portfolio, to the specific shopping center, and ultimately the tenant.

Now that you know the basics of the TEDA rule, there are a few other letters I would like to share with you before applying the TEDA rule. Because of the importance but the difficulty of getting the Insurance Declaration Page and Schedule of Premiums from the landlord, the very first step for any lease administrator is to calculate the cost per square foot (CPSF) of the insurance you are paying and compare it to see if it is reasonable. If reasonable, move on to something that will save more money and consumes less time. However, reasonable is always difficult to define and even more difficult for insurance because of factors such as type and age of shopping center, geographic location (earthquakes and hurricanes), and the lease language. As a guideline, we use a baseline range for properties in non-earthquake, non-hurricane or non-flood areas of .15 to .50 cents per square foot. If you are in one of the natural disaster prone areas, it could be as high as $1.25 per square foot. It may also be beneficial to group and compare other locations within your portfolio in the same geographic areas to benchmark insurance cost to decide what is acceptable and what is not.