



SCOTT ROYLE KNOWS A DISTURBING TREND WHEN HE SEES ONE, and he doesn't need numbers from the trade press or the burgeoning stack of submissions for clarity. The view from his Irvine, Calif., office window says enough.

"I look out and see three seven- to 12-story buildings completed and totally unoccupied," he says. As vice president of American E&S Insurance Brokers, Royle is no novice to vacant-property insurance, a perennial excess and surplus lines product. But what he's been seeing lately is different. "What's happening now—buildings completed with no tenants ready—is very different. It's not normal."

"Dismal" is the most popular

adjective used by those reporting on today's commercial real estate marketplace. And it's getting worse. The numbers could inspire a Bruce Springsteen song.

Office vacancies ended 2009 at 17.6%, up from 14.8% at year's end in 2008, according to commercial real estate firm Grubb & Ellis' 2010 U.S. Forecast Report. Industrial vacancies rose to 10.7%, and retail vacancies are expected to hit 11.7% by the end of 2010. The marketplace continues to absorb hundreds of millions of vacant square footage. Commercial vacancies are likely to set a modern-day record by the end of this year, warns Grubb & Ellis.

Ed Magliaro, executive vice president and national practice leader for property at Swett & Crawford, has sifted through vacant-property submissions for years. He admits that the current marketplace is the first time he's seen the demand for vacant-building insurance so high, "particularly for large properties." He says it's shocking to be getting calls from retailers trying to find vacancy coverage for a \$500 million to \$700 million property. "In the past, vacancies were one-offs or local situations, not tied to any gen-

eral economic event. Now it's pretty much a national issue with certain areas of the country being affected more severely than others and every segment of the economy feeling some impact."

As a growing contingent of financial institutions takes possession of properties, identifying who will manage the property and who is ultimately the named insured becomes difficult.

"So many of the properties we see today are in bankruptcy or some other adverse financial situation," Magliaro says. "When this happens, a determination has to be made as to who is in control of the property. Is it a bank? The developer? The original owner? This information is every bit as important to underwriters as specific construction data on the real property."

Also imperative are the circumstances in which the building became vacant. Many risks are "normal vacant"—Magliaro's term for properties that are in preparation for sale or between leases. "Traditionally with vacant property, the property and owner were not necessarily under financial pressure—just in transition," he says. A growing number of risks are what he calls "economy vacant." These properties are of greater concern for underwriters because their future is uncertain. In more and more cases, they are abandoned because the insured ran out of money.

Royle says another disturbing part of this trend is that investors are buying properties from banks for pennies on the dollar without the necessary infrastructure to manage them. Insurance folks are typically kept in the dark regarding these transactions until the 11th hour, and limited underwriting information makes it difficult to price and to underwrite the schedules accurately.

With evidence that the risk in

this property is increasing, insureds often receive policies containing protective safeguard restrictions, warranties and other unfamiliar conditions that must be highlighted at the time of binding. Failure at this stage of the process by an inexperienced retailer could prove catastrophic.

Further, Royle says inexperienced retailers may be sympathetic to an insured's insistence that the situation is short-term. Insureds tend to be "overly optimistic" about occupancy, he says. Vacancy policies typically have many policy-period options, and it's tempting to lowball expectancy to keep the premium down. But Royle warns that philosophy can easily backfire. "As vacancy stalls, this usually means a greater moral hazard and subsequent higher premium at renewal. A longer policy term helps ensure rate consistency over a greater time period."

While coverage for vacant properties is not exclusive to the E&S markets, both Royle and Magliaro agree that an experienced wholesaler is in a better position to manage the new dynamics of the marketplace and to help inexperienced retailers educate insureds about their new policies.

"E&S folks are used to the risk. Our experience helps us make quicker decisions and acquire higher limits. For larger programs, we bring proper structure to the placement," Magliaro says.

Experts don't expect signs of improvement anytime soon. Some reports cite the third quarter of 2011 as a possible turning point, but the prediction's lack of supporting evidence is unnerving. Until then, a wholesale broker's risk experience and market access may be the tools retailers need to sustain insureds through recovery.

Empty Inside

Rising commercial vacancies may cause problems for retail brokers inexperienced in commercial real estate.

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