New market realities

How property insurance changes are affecting commercial real estate lending

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The commercial real estate market is facing a number of challenges. Among the most pressing are the new market realities being reflected in certain property insurance coverages that are affecting borrowers' new and existing loans.

"Certain long-standing insurance requirements simply are not available any longer or are undergoing significant adjustment," says Joseph A. Pope, an attorney with Babst Calland. "It's playing out in real time between borrowers and their attorneys and lenders."

Smart Business spoke with Pope about how changes in property insurance coverage are affecting commercial real estate lending, and what borrowers need to know about it.

HOW IS PROPERTY INSURANCE CHANGING?

Certain property insurance coverage is no longer available that had historically been part of lenders' standard coverage requirements. Sometimes those considerations are geographic. For instance, in Florida there are types of property insurance that are either no longer being offered, or providers won't cover certain properties as insurance companies have essentially hit their maximum amount of risk in the state. In Midwest and Gulf Coast states, changes to hail, windstorm and named storm coverage policies are affecting deductibles and certain payouts for these specific coverages. Similar changes are affecting property insurance in essentially all U.S. markets, including Pennsylvania, whether by way of loss of coverage, higher deductibles or increased premiums.

WHAT NOW MUST BE NEGOTIATED WITH LENDERS?

Property owners with existing loans in affected jurisdictions now must explain to their lenders that they may no longer be able to fulfill certain loan requirements that are predicated on insurance coverage. Lenders have been slow to proactively update their previous standard minimum requirements on property loans and there's no guaranty they will do so in a borrower-friendly way.

Existing borrowers should talk with their lender about any modifications that need to be made to their insurance requirements because of new market realities before delivering an insurance certificate that doesn't comply with the lender's current loan requirements. An attorney can offer the best advice to borrowers that are not able to provide insurance that complies because of a market-forced change.

Borrowers looking for a new commercial property loan will need to address these issues early in the application process because it may require getting a lender to come to grips with the borrower's ability to secure certain insurance coverage. Having coverage preapproved at the time of application avoids the headache of having to negotiate it later.

WHY SHOULD BORROWERS INVOLVE THEIR ATTORNEY IN THE APPLICATION PROCESS?

When looking at lenders, companies often look first at interest rates. Given the rise in rates, certain non-bank lenders, such as Life Companies, have been able to offer more appealing rates for commercial property loans. But while the lower rates are attractive, they're likely to come with more points of legal negotiation upfront, including as early as the application process. This can amount to the application for the loan becoming an enforceable loan document.

With certain lenders, potential borrowers may now expect to receive loan applications that are many pages long with a number of binding boilerplate clauses, many of which were historically negotiated during the loan documentation process. When this is the case, they should run it by their legal counsel to ensure they're clear on what they're agreeing to. Counsel who is familiar with these types of documents can identify provisions and exceptions that could be unfavorable to the borrower.

While the lower rate a non-bank lender can offer is preferred, there can be more rigidity in their lending process vs. that of a conduit lender or even a traditional bank. In either case, borrowers should involve their attorney in the process early to avoid inadvertently binding themselves to any kind of loan provisions in the application process. The faster that a borrower can identify, address and negotiate those issues, the more leverage they'll have to negotiate, and the more likely an efficient, timely closing will occur. ●