

# COVID-19 and Commercial Property Vacancy Concerns

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As of this writing 38 states and countless cities and counties have enacted some form of stay-at-home order amid the pandemic panic arising from COVID-19. If the operation is not considered an "essential" business, its doors are shut - for now. How long such orders will or even can stay in place is anyone's guess.

With "non-essential" businesses sitting non-operational, might the commercial property policy's vacancy limitation apply to an otherwise covered loss? Unfortunately, there is **no** single answer. This is another question that will force agents into the coverage form to understand the policy they sold; undertaking this exercise will prove to agents that not all policies are created equal.

## **Is the Property Vacant according to ISO?**

Whether the property is considered "vacant" is **wholly** a function of the policy language. Insurance Services Office's (ISO's) vacancy provision reads:

### ***E. Loss Conditions***

#### ***6. Vacancy***

##### ***a. Description Of Terms***

*(1) As used in this Vacancy Condition, the term building and the term vacant have the meanings set forth in (1)(a) and (1)(b) below:*

*(a) When this policy is issued to a tenant, and with respect to that tenant's interest in Covered Property, building means the unit or suite rented or leased to the tenant. Such building is vacant when it does not contain enough business personal property to conduct customary operations.*

*(b) When this policy is issued to the owner or general lessee of a building, building means the entire building. Such building is vacant unless at least 31% of its total square footage is:*

*(i) Rented to a lessee or sublessee and used by the lessee or sublessee to conduct its customary operations; and/or*

*(ii) Used by the building owner to conduct customary operations.*

*(2) Buildings under construction or renovation are not considered vacant.*

Two key qualifiers in this language determine what constitutes a "vacant" building:

- **For policies issued to a tenant:** *Such building is vacant when it does not contain enough business personal property to conduct customary operations.*
- **For policies issued to building owners or lessees of an entire building:**

*Such building is vacant unless at least 31% of its total square footage is:*

*(i) Rented to a lessee or sublessee and used by the lessee or sublessee to conduct its customary operations; and/or*

*(ii) Used by the building owner to conduct customary operations.*

When the insured is a tenant occupying only part of the building, the policy language appears clear. The limitation is a “property-based” limitation; the building is considered vacant if there is not enough business personal property to conduct customary operations. Presumably all the equipment and contents are still in the building, they just aren't being used. Lack of use does not make it vacant, just presently unoccupied. The vacancy limitation does not appear to apply.

Coverage for building owners and general lessees (lessees of the entire building) doesn't read as clearly, but the result seems to be the same – the vacancy provision does not appear to apply to owners or general lessees when the operations are stalled. Let's explore what makes the building vacant:

- The building is vacant if less than 31% of the square footage is leased and used by the tenants to conduct customary operations. Let's assume that the entire building is leased, but the tenants are not currently operating because of the forced shutdown – does this make the building vacant? There is ambiguity in the phrase, “**used by...to conduct its customary operations.**” The space is still used by the lessee to conduct its operations, just not currently. The form doesn't say, “in use.”

To require active use would greatly contradict the coverage extended to the tenant. The tenant has coverage under its policy because of the presence of business personal property. The building owner has coverage because of the presence of tenants. Neither provision requires active operations, just the ability to conduct operations immediately.

- When the policy is issued to the building owner and the owner is the sole occupant, the building is considered vacant if/when less than 31% of the building is used by the building owner to conduct customary operations. This is a “**how the building is used**” provision not a “**when the building is used**” requirement. The form states, “used by the building owner,” not “while being used....” If the required percentage of the building is used by the building owner, it is not vacant.

Perhaps a quick example. Assume an insured gets an incredible deal on a large building. The building is much larger than is needed, but the deal is too good to pass up. The insured purchases a 100,000 square foot building; however, the operation is small and requires only 10,000 square feet. By definition, this building is vacant because only 10% of it is used to conduct customary operations.

However, if the insured occupies the entire building to conduct customary operations, the building is not vacant – even if the operations are temporarily on hiatus. The building is used by the building owner to conduct customary operations as evidenced by the machinery and equipment in the building; it's just not presently **in** use.

ISO language is clear regarding coverage for tenants. As long as there is enough equipment to operate the business, the building/space is not vacant.

For building owners and general lessees, the vacancy language is not as clear, the language is more nuanced. Policy language does not require “active” operation only that the building is leased to tenants (to a certain minimum percentage) for them to conduct operations or for the building owner to conduct customary operations.

Based on ISO wording, the building is vacant if there are no or not enough tenants or lacks the equipment necessary to conduct customary operations. The goal is to penalize the insured only when/if the building cannot be used for its intended purpose because there is no equipment in the building. Remember, ISO vacancy provision is based on the presence of stuff, not people.

### **Proprietary Forms – Are They Different?**

Some carriers apply a proprietary definition of vacant that can and often does change how the provision applies. Following is one carrier's redefining of what qualifies as vacant:

1. ***Vacant means that:***

1. *70% or more of the rentable square footage of a building at an insured location is not being **actively used by you or a tenant for its intended purpose**; or*
2. *70% or more of the total square footage of a building at an insured location utilized by you to conduct **your business** is no longer used to conduct your customary **operations**; or*
3. *A building at an insured location utilized by you to conduct **your business** does not contain enough **business personal property** to conduct your customary **operations**;*

*whether or not you intend to use or rent such building.*

Unlike ISO's policy language, the wording in 1.a. is an **activity-based qualifier**. If at least 70% of the building is not being **actively** used, it is vacant. Given the pandemic panic quarantines and the government-ordered closures, many buildings may not be in active use. Not being in active use triggers the policy's vacancy limitation.

Although the qualifier “rentable” in 1.a. appears to limit this provision to tenant-occupied buildings, the subparagraph continues, “...actively used by **you**...” The “you” is the named insured. Based on this wording, it can reasonably be assumed to mean “rentable” square footage IF the insured owner desires to rent the space – even if they don't, rather choosing to use the space themselves.

Subparagraph *1.b.* looks similar to ISO's wording, but closer review generates a different interpretation. The phrase, "...*is no longer used...*" is, in accord with subparagraph *1.a.*, an activity-based trigger. The wording appears to require the business to be operational. If at least 70% of the building is not being actively used to conduct operations, the building is vacant.

The vacancy trigger in *1.c.*, like ISO's vacancy trigger, is property-based rather than activity based. If at least 70% of the building does not contain enough business personal property to conduct normal operations, the building is vacant.

Why might this redefining of "vacant" be more restrictive and even more punitive than ISO's wording? Because of the conjunction, "**or**" between the triggers. "Or" is an exclusive term meaning that if **any** of the conditions apply, the building is considered vacant.

Notice that ISO divides the triggers between policies written for tenants and policies extending coverage to building owners and general lessees. This particular form lumps the wording together and uses, "or." Regardless of the intent, subparagraphs *1.a.* and *1.b.* make this an activity-based limitation. Further, the use of "or" makes the provisions equally applicable to a building that is tenant-occupied or one that is owner-occupied.

The most glaring difference between ISO's vacancy provision and this form's wording is square footage. ISO's requires occupancy of only 32% or more of the building. This form requires that 70% or more of the building be occupied and actively used.

### **The Results of Vacancy**

ISO's vacancy provision takes affect after 60 days of defined vacancy. If the building is vacant, the policy completely **excludes** any loss caused by:

- Vandalism;
- Sprinkler leakage, unless you have protected the system against freezing;
- Building glass breakage;
- Water damage;
- Theft; or
- Attempted theft.

All other losses caused by a covered cause of loss are paid, but the claim payment is reduced by 15%.

Proprietary forms may mirror ISO language or contain their own exclusions and limitations. The form must be reviewed.

### **Be Prepared**

Whether and how the vacancy limitation applies is, as has been shown, a function of the policy language. If the policy applies ISO or similar language, the vacancy provision is based on and is triggered by the presence or lack of sufficient business personal property to conduct customary

operations. As long as operations CAN be conducted, the building is not vacant – even if operations are currently being conducted.

If the applicable policy language is **activity based**, once activity ceases, the clock begins to tick. If there is no activity beyond the prescribed number of days, the vacancy provisions are triggered – whatever they might be.

Review the insured's policy and any endorsements specific to the vacancy provision. Notify the insured of potential coverage problems if the anticipated vacancy (as defined by the policy) will last beyond the specified number of days. Unfortunately, this may become a policy-by-policy endeavor.

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