



ACE ADVISORY

MANAGING REAL ESTATE LIABILITY RISK IN A CHANGED MARKET

Joseph Fobert

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The U.S. commercial real estate market continues to face a range of risk management challenges as a result of shifts in the financial market. The rapidly changing environment has led to high turnover in real estate portfolios and controlled capital expenditure budgets as companies seek cost reductions in an effort to improve their competitive position. As the market returns to more normal conditions, risk management considerations that had been put aside are once again coming to the forefront. Liability claims have been increasing in both frequency and severity, which may lead to higher deductibles and self-insured retentions and more restrictive terms and conditions.

Some risks have become greater, while others are emerging. For instance, New York's Scaffold Law continues to present significant challenges with more awards reaching into the millions of dollars. Meanwhile, many owners of residential real estate properties may have to deal with completed operations and construction defect exposures that may not have been priority concerns in the past. Some firms may face heightened liability risks stemming from reductions to capital improvement and operational expenditures. Emerging exposures include the requirements of the Americans with Disabilities Act, the push for energy efficient buildings and increased awareness of indoor air quality problems. To mitigate their exposures and the potential costs associated with them, companies need to reinforce their risk management efforts, develop strategies to address both the new and familiar exposures and review their primary and excess coverage.

New York's Scaffold Law

New York's Scaffold Law, also known as Labor Law 240, remains an anomaly in the country as the only one of its kind still on the books. The law, which dates back to 1885, holds owners and contractors absolutely liable for damages when a worker is injured in a fall from height as a result of a violation of the statute, regardless of fault on the part of the plaintiff. Critics contend that the law needlessly drives up the cost of construction for both public and private projects and that it sharply increases the cost of liability insurance while reducing its availability. Still, the state courts have widened the scope of the law over time. New York's highest court ruled in 2009 that in addition to falls and falling objects, the law also extended to injuries caused when workers restrain objects.¹ Awards in 2012 in Scaffold Law cases ranged as high as \$3 million to \$15 million, the New York Times reported.² There have been calls to reform or repeal the law, as Illinois did to its version in the 1990s, but it remains on the books.

For property owners, the liabilities created by the law make it imperative to review their contractual language with third-party contractors to make sure that the additional insured coverage and hold-harmless clauses are appropriately robust. The documentation and enforcement of these contract provisions also needs to be strict. When work is being performed at a location, risk managers should demand that contractors ensure that there is always a supervisor on site.

Construction and Products Related Liability

Firms that acquired properties during the real estate boom or afterwards may face heightened completed operations and construction defect exposures on projects built during that time period. Because of the high demand for contractors during the boom, many owners did not require adequate completed operations coverage in their contracts with general and third party contractors. The typical exposures are related to construction defects and



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product quality such as problems with the installation or construction of windows. Because there is typically a seven-to-ten year tail, claims stemming from projects completed during the market shift are starting to become more frequent.

For companies considering acquisitions, it is crucial to research the contractors that performed the work to see whether they are still in business and to assess the status of their completed operations insurance. Companies that have already acquired properties where the risks may not have been adequately reviewed need to identify areas with potential shortcomings and develop plans for addressing them.

Maintenance and Capital Expenditure Exposures

As the real estate market changed, many companies sought cost savings in their capital spending budgets. That pullback in spending was reflected in some cases with reductions in security staff and deferred maintenance, such as re-paving parking lots or repairing sidewalks. While those reductions helped to keep costs in check at a crucial time, they may have led to increased bodily injury exposures, such as slip-and-fall incidents. On properties where security staff has been reduced, property owners need to keep in mind that in the event of a lawsuit, plaintiffs may try to show that staff cuts were a contributing factor in causing an incident. Companies that have acquired properties, particularly distressed assets, where maintenance and security issues have been neglected or deferred need to identify and correct those problems.

Terrorism Insurance a Concern

A major concern for property owners in urban areas that may pose a high risk of terrorism is the scheduled expiration of the Terrorism Risk Insurance Program Reauthorization Act at year-end 2014. The law, which was a seven-year successor to the Terrorism Risk Insurance Act enacted in 2002 after the World Trade Center attacks, has established a federal backstop for terrorism risks that has allowed insurers to offer coverage for these risks. Several bills have been introduced in Congress to extend the act for an additional five to ten years as property owners and others await further action.³

To mitigate exposures and the potential costs associated with them, companies need to reinforce their risk management efforts, develop strategies to address both the new and familiar exposures and review their primary and excess coverage.



Americans with Disabilities Act

Another federal law with significant implications for the real estate industry is the Americans with Disabilities Act (ADA), which requires property owners to provide access for disabled people wherever there is public access to a site. This includes office, retail, residential and hospitality properties. One risk that may be overlooked is the fact that anyone may file a complaint with the regulatory agency under the law, and not only disabled people who may have been directly affected. Those third-party complaints may result in fines, and the government recently increased the penalties to adjust for inflation. In early 2014, the U.S. Department of Justice raised the maximum fine for a first offense to \$75,000 from \$55,000 to adjust for inflation, and to \$150,000 for a subsequent violation, the first increase in fines since 1999.⁴

One of the big recent changes that came into effect this year is the requirement to have lifts and trained operators at swimming pools that provide public access.⁵ This regulation is having its greatest impact on the hospitality industry.

To make sure that their properties are in compliance, building owners should review their properties in light of the public access requirements to identify any areas where there may be deficiencies. Because of the complexities of the ADA, it may be prudent to work with experts who can identify potential shortcomings and recommend solutions. While fines, penalties and orders to make building modifications are generally not insured, from a financial perspective, risk managers should work with their brokers to optimize their insurance coverage in the event of a third-party action for damages.

Energy Efficiency and Carbon Monoxide Monitors

With the increased drive toward energy efficient buildings, property owners need to be aware not only of the potential long-term cost savings and other advantages, but also of the risks. It is not only new buildings where this is a concern. Buildings that have been significantly damaged may be required to be retrofitted to meet energy efficiency standards as a condition of receiving permits or meeting lender requirements. Retrofitting buildings to increase their energy efficiency or to make them more attractive to tenants can create additional exposures for a property owner. For instance, if a ventilation system is not properly maintained it could worsen indoor air quality by spreading allergens.

Before beginning a retrofit or new project, property owners should make sure that contractors have the expertise to properly perform the work. Building owners and their brokers should make sure that they have the right liability coverage in place and should check to see whether they may need pollution coverage for environmental risks such as indoor air quality issues.

Depending on the state, all new buildings may be required to have hard-wired carbon monoxide monitors, but real estate companies should consider such monitors for all of their properties. This helps to protect tenants and visitors as well as the company because a lack of hard-wired monitors may be seen as a failure to adopt best practices. In addition, it is important to make sure that the monitors are properly maintained, and if they are being maintained or installed by third parties, owners have the right risk transfer language in place.

Managing Risk in an Ever-Changing Market

Over the past few years, the U.S. commercial real estate industry has experienced a range of challenges. Now, companies should strengthen their risk management efforts by identifying areas where exposures may have grown or been overlooked and developing strategies to mitigate them. Companies should evaluate their current properties as well as potential acquisitions to ensure that the construction and materials meet the appropriate standards. It is also important to review contractual language with vendors and contractors to ensure that it provides adequate protection from a risk management perspective. An insurance carrier that understands both the potential risks and the real estate industry can provide valuable expertise during this process.

Companies also should assess their insurance program to make sure that they have the appropriate coverage in light of today's heightened exposures. This should include a review of their primary and excess programs for sufficient limits and suitable terms and conditions. It is important to look for a financially strong insurer that has the claims handling expertise and a solid, consistent track record in the industry.

The real estate market is always changing. Companies need to make sure that their risk management and risk transfer strategies keep pace with the evolving risks.

ABOUT THE AUTHOR:

Joseph Fobert is Senior Vice President of Underwriting for Corporate Risk Excess Casualty, a division of ACE USA. In this role, Mr. Fobert is the U.S. manager of the Corporate Risk Excess, Express online umbrella platform and Excess Casualty programs segments. Mr. Fobert joined ACE in September 2013, and prior to joining ACE he worked for several insurance companies in both underwriting and management capacities. Mr. Fobert has drafted numerous coverage forms and endorsements, and has been quoted in industry leading publications such as the National Underwriter on both real estate and "green" insurance topics, and authored several industry white papers. With more than 20 years of industry experience, Mr. Fobert started his career in insurance out of college on the agency side. He holds both Chartered Property Casualty Underwriter (CPCU) and Associate in Risk Management (ARM) designations. Mr. Fobert completed his MBA at the College of Insurance with a dual concentration in Risk Management and Finance.

Endnotes:

- 1 Runner v New York Stock Exchange, Inc., 13 N.Y. 3d 599 (2009)
- 2 Semple, Kirk, "Contractors and Workers at Odds Over Scaffold Law," New York Times, Dec. 17, 2013. See, http://www.nytimes.com/2013/12/18/nyregion/campaign-underway-to-amend-scaffold-law-protecting-construction-workers.html?_r=0
- 3 H.R. 1945. See, <https://www.govtrack.us/congress/bills/113/hr1945>
See also, <http://beta.congress.gov/bill/113th-congress/house-bill/2146>
See also, <http://www.businessinsurance.com/article/20140608/NEWS04/306089963?tags=%7C306%7C76%7C73%7C88>
- 4 Civil monetary penalties inflation adjustment under Title III, U.S. Department of Justice See, http://www.ada.gov/civil_penalties_2014.htm
- 5 Accessible Pools, Means of Entry and Exit, U.S. Department of Justice, See, http://www.ada.gov/pools_2010.htm

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