

## AMERICAN RISK MANAGEMENT RESOURCES NETWORK, LLC

### ***A Lenders Guide to Mold Insurance Coverage***

#### ***On***

#### ***Secured Property***

#### **Introduction**

A new generation of mold ***related*** claims exclusions leave unprecedented numbers of borrowers in non-compliance with the insurance requirements in commercial loan covenants. There are affordable insurance solutions available today to insure the mold loss exposures in commercial property. If lenders encouraged their borrowers to meet the insurance requirements of their loan covenants, their borrowers will automatically have access to the state of the art water intrusion and mold loss control protocols that have been developed by specialized environmental insurance underwriters over the past five years. By utilizing these innovative insurance products property owners no longer need to be uninsured nor their lenders unsecured for mold related damages.

Affordable environmental insurance products for commercial properties over 50,000 sq. ft. have been introduced that can effectively fulfill the insurance coverage requirements in loan covenants for as little as five cents per square foot on an annual basis for a policy with a \$5,000,000 limit of liability. The most comprehensive of these insurance products, Real Estate Environmental Liability/Highly Protected Risk with Mold, (REEL/HPR/Mold) provides building science based loss control services in addition to filling the mold and other environmental contaminants coverage gaps in the borrowers property and liability insurance on the property.

Unlike the insurance industry lenders have been very slow to actively manage their new loss exposure to toxic mold. This is due to a number of interrelated factors including:

- A basic misunderstanding of the effects of mold related claims exclusions by all parties involved with a securitized loan, including the insurance professionals.
- Insurance agent's failure to disclose mold exclusions in the certificates of insurance issued to lenders.
- A misguided perception that affordable solutions to manage water intrusion and mold risks are not available.
- A basic lack of awareness of the insurance coverage alternatives for mold damages in the highly specialized and complex environmental insurance market place.

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- Lenders, banking regulators and credit rating agencies did not recognize that if insurance companies were dumping billions of dollars of uninsured toxic mold claims back into the economy in a panicked frenzy of exclusions, what effect that would have on lenders. The over one hundred million mold exclusions issued annually will have a material impact on somebody. Due to loan to value ratios, these people will disproportionately be loan officers with non-performing loans.

### **New Generation Mold Related Claims Exclusions**

Property insurance policies have excluded losses where mold was the proximate cause of the loss for more than 50 years. However with their new mold *related* claims exclusions, insurance companies have drastically stripped out insurance coverage for all damages in anyway associated even indirectly with mold. An illustration of the dramatic impact the new generation of mold exclusions follows:

Assume wind breaks the glass in a hotel and wind driven rain enters the building. Unable to find qualified contractors, drying equipment and power within a day, visible mold growth ensues by the third day contaminating the entire building. The restoration takes three months to complete. The cost of replacing the glass is \$10,000. The cost to remediate mold from the entire structure costs \$700,000, which involves removing and replacing all porous surfaces including the wallboard, carpeting, beds, linens, couches, and drapery. The business interruption loss is \$700,000.

Under the original mold exclusion in the property insurance policy the entire loss of \$1,410,000 would be insured because the proximate cause of the entire loss was an insured peril (wind driven rain). The effect of the new mold related claims exclusion is to eliminate coverage for everything but the glass. One very prominent insurer of commercial property excludes damage that was directly or indirectly arising out of, caused by, resulting from, contributed to, or aggravated by mold. With this exclusion on their property insurance policy the owner of the hotel would likely only receive \$10,000 from their insurance company since all of the other damages were at least "indirectly" "contributed to" by mold.

This claims settlement could not be what the secured lender had in mind when they required "All-Risk" property insurance to protect their security interest in the loan. If the borrower in this case did not have enough cash to cover \$1.4 million of unexpected costs, or if the borrowers net equity position was less than the loss, without insurance the lender will be left holding the keys on a property that could very well be worthless. This is an insurance coverage outcome banking regulators and rating agencies would not expect either.

The above example illustrates why an All Risk property insurance policy with a mold related damages exclusion endorsement does not fulfill the requirements of a loan covenant requiring All Risk property insurance.

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### **New Mold Coverage Restrictions in General Liability Policies**

In addition to All Risk property insurance policies lenders universally require that borrowers maintain liability insurance to protect against the contingency that the borrower becomes involved with a lawsuit that drains them of assets, resulting in an unpaid loan.

Just like the property insurers, liability insurers have issued mold related claims exclusionary endorsements across the board. Mold related claims exclusionary endorsements in General Liability insurance policies eliminate coverage for liability arising from the premise, operations, products and completed operations of the insured. As a result developers, owners, contractors and building product suppliers no longer have liability insurance for mold related damages in their General Liability insurance policies either. Prior to these new mold related claims exclusions there was coverage for mold damages in a General Liability policy. Because the proximate cause of mold is water and water is not a “pollutant”, the traditional pollution exclusion in General Liability policy does not eliminate coverage for a mold loss.

The new mold related claims exclusion endorsements in liability insurance policies also create a material gap between the Commercial General liability insurance specified in loan covenants and the insurance being provided by the borrower.

### ***How to Specify Appropriate Mold Coverage***

To assure the lender actually is secured for mold related damages specific language addressing mold losses should be added to the insurance section of loan covenants. (see the link below) It is important to note the mold coverage we suggest for use in the lender’s insurance specifications is designed to get the borrower and lender back into the insurance position they were in prior the introduction of new mold related damages exclusions.

Affordable solutions to mold related insurance coverage gaps exist within the environmental insurance market place but they are rarely utilized. REEL/HPR/Mold insurance was developed by American Risk Management Resources Network, LLC. specifically to address the insurance coverage gaps created by mold related claims exclusions in both General Liability and All Risk property insurance policies. This unique form of environmental insurance combines building science based loss control which has a proven track record to be 14 times more effective at preventing water intrusion and mold losses than the national averages. The REEL/HPR/Mold also features multi-year policy terms up to 10 years, and insures multiple parties including the developer, owner, contractor and even the lender under one insurance policy. A REEL/HPR/Mold policy insures the clean-up of mold on a no-fault basis, which fills the mold coverage gap in the All Risk property insurance policy and provides liability insurance for mold related damages which fixes the mold coverage gap in the General Liability policy.

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Only with one of these customized policies in place would borrowers be in compliance with a loan covenant requiring both All Risk Property insurance and General Liability insurance if those policies had mold related claims exclusions.

### **Conclusion**

This paper summarizes a number of complex insurance coverage issues created by mold related claims exclusions. Space does not allow us to detail many of our observations and suggestions. We strongly encourage readers to use the following resources and call us with any questions.

- For a more complete discussion of mold exclusions and coverage solutions request a copy of “How Lenders Were Left Unsecured For Mold Related Damages And How To Fix It.” From [webmaster@armr.net](mailto:webmaster@armr.net)
- For insurance specifications for mold coverage see [www.armr.net/lenderspec](http://www.armr.net/lenderspec)
- For more information on mold insurance and risk management alternatives see the web site of The Environmental Risk Resources Association [www.erraonline.org/mold.htm](http://www.erraonline.org/mold.htm)
- For information on the REEL/HPR/Mold insurance product please see: [www.armr.net/reel.html](http://www.armr.net/reel.html).

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