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PROPERTY INSURANCE AND THE REAL ESTATE MELTDOWN

A Matter of Good Public Policy for Florida

The current financial crisis and meltdown in real estate has affected Florida in an unprecedented way. Not since the late 1920's great Florida land bust have we seen the type of stress imposed on the real estate sector. Will we recover? Probably, given Florida's natural attractions of sun, beaches, world class resorts and a favorable retirement environment. But what if the long overdue **BIG ONE** (hurricane) hits in the midst of this current real estate meltdown? One does not have to be a sage to realize the possibility of large sections of Florida's real estate being left in ruins and not being repaired or removed in the aftermath of a major hurricane strike.

Folks that are being foreclosed on, and banks that are financially stressed, are not likely to rush to spend insurance dollars for repairs or demolition on these upside down properties. Will the results be neighborhoods already distressed left in ruins?

Sound far fetched? One only has to look at recent articles in the national media, as well as anecdotal stories providing examples of the problems experienced in other sections of the country, to give us pause. According to media reports, our "rust belt" cities in the North have been experiencing problems with distressed and abandoned properties in an unprecedented way. We need to take notice of what is happening and prepare and plan now in order to learn from these other communities' struggles.

The Media Reports

Standard & Poor's/ Case-Shiller Home Price Indices reports a record breaking descent in their January 2009 index of home prices. This index tracks prices in 20 metropolitan areas and according to an article published in the Wall Street Journal (2009, April 1), Miami and Tampa are listed in this index as having approximately a 45% and 38% decline respectively after the peak values reported in 2006. Other areas of Florida not listed in this 20th largest metropolitan area

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study with large inventories of distressed housing include, but are not limited to, Cape Coral and Ft. Myers area.

On March 4, 2009, National Public Radio (N.P.R.) broadcasted a piece on the economy entitled, “Banks Refusing to Take Back Foreclosed Properties.” This was followed by an article in the New York Times entitled, “All Boarded Up,” (2009, March 8). The Miami Herald reported on this problem in their article entitled, “South Florida Cities Act to Prevent Blight in Foreclosed Homes,” (2009, March 14).

Most recently, this problem was covered in a front page article in the New York Times entitled, “In Foreclosure A Rise in Banks Walking Away,” (2009, March 30). Seemingly we now have a new financial term to describe the real estate problem whereby distressed real estate is simply referred to as “Walkaways.”

It seems as though the problems are many, and the cost so great for the care and/or removal of abandoned, damaged and destroyed homes and buildings, that refusing to take possession of the property deed appears to be the only solution for not only the property owner but also the financial institution that holds the mortgage. A deed to some real property has now become a “hot potato.”

The problems that have evolved with burnt out buildings as well as abandoned, distressed properties in “rust belt” cities, need to be a clarion call to our leaders in Florida. Don’t think this is strictly a “rust belt” problem. In an article published in the St. Petersburg Times (2009, April 12) two diametrically opposed professionals, one a Palm Beach consumer activities lawyer, and the other a former CEO of the State’s largest landholder, seem to agree that, “real estate prices are in a free fall--300,000 homes stand vacant.” Make no mistake; this is not just a Florida problem or “rust belt” cities’ problem in this real estate bust. It is a systemic problem across all areas that are exposed to hurricane, flood and earthquake perils.

Hurricanes - Ruins, The Cost

A typical hurricane damaged home can easily exceed ten thousand dollars (\$10,000) to remove the house and scrape the slab provided it does not include any of the following parade of horrors such as asbestos, lead paint, household pollutants and Chinese drywall. Costs can double or triple for commercial buildings, and large condominium towers can amount to the six figure range.

A Solution

Rather than the tax payers picking up the tab as a result of FEMA's involvement, financial relief may be available through already bought and paid for insurance coverage. The property insurance **debris removal** provisions may provide some financial relief for the expected huge financial burdens the communities may face. It would, however, take some "outside-the-box" thinking to make this a reality. As an example, do the cities and communities meet the definition of having a pecuniary interest in the properties in order to have an insurable interest thus allowing them to be named as a **loss payee** in the property policies?

We believe that as a matter of great public interest/policy the Florida Legislature and/or the Florida Office of Insurance Regulation should allow cities and communities to be named as **Loss Payees** on all property insurance policies for the purpose of securing debris removal funds in the event the property owners and banks walk away from damaged or destroyed properties. This will allow the cities and communities that will have to clean up the mess to file claims under the property insurance policy and thus will insure that they will not be left with this financial burden.

INSURANCE COVERAGE

It is well established that if properties have a mortgage, the mortgage company will require a property insurance policy in order to protect their security for the loan they made. While these policies cover the cost to repair/replace, they also have provisions for debris removal expenses. Typically, in the repair dynamic of a damaged property, debris removal is paid as part of a settlement for repairs. If the structural loss exceeds the policy limit or is a "total loss," debris removal will often be offered as an

“additional coverage” provision expressed as a percentage of the building limit (Coverage A) with a “not to exceed” provision.

The following debris removal clauses were taken from three (3) different property policies approved by the Florida Office of Insurance Regulation. You should note the differences in that one of the policies does not require debris removal to be “incurred” while the other two do. This is not a minor scriber’s error, but in fact a big benefit to the policyholder. The much maligned Citizens does not require you to actually do the work or incur the expense for debris removal to be paid.

1. **State Farm:**

Section 1 - Additional Coverages

The following Additional Coverages are subject to all the terms, provision, exclusions and conditions of this policy.

1. **Debris Removal.** We will pay the reasonable expenses you incur in the removal of debris of covered property damaged by a Loss Insured. This expense is included in the limit applying to the damaged property.

When the amount payable for the property damage plus the debris removal exceeds the limit for the damaged property, an additional 5% of that limit is available for debris removal expense. This additional amount of insurance does not apply to Additional Coverage, item 3. Trees, Shrubs and Other Plants.

We will also pay up to \$500 in the aggregate for each loss to cover the reasonable expenses you incur in the removal of tree debris from the residence premises when the tree has caused a Loss Insured to Coverage A property.

2. **Nationwide**

Additional Property Coverages

These additional property coverages are subject to the policy deductible except as noted. In no event will the deductible be applied more than once to any one loss.

1. **Debris Removal.** We will pay reasonable expense you incur removing debris of covered property, if the peril causing the loss is covered. An additional five (5) percent of the limit of liability for the damaged property will be available when the amount payable for the property loss plus the debris removal expense exceeds the limit of liability.

3. **Citizens**

Additional Coverages

1. **Debris Removal**

We will pay your reasonable expense for the removal of:

- a. Debris of covered property if a Peril Insured Against that applies to the damaged property causes of the loss; or
- b. Ash, dust or particles from a volcanic eruption that has caused direct loss to a building or property contained in a building.

This expense is included in the limit of liability that applies to the damaged property. If the amount to be paid for the actual damage to the property plus the debris removal expense is more than the limit of liability for the damaged property, an additional 5% of that limit of liability is available for debris removal expense.

We will also pay your reasonable expense, up to \$500 for the removal from the “residence premises” of:

- a. Your tree(s) felled by the peril of Windstorm or Hail;
- b. Your tree(s) felled by the peril of Weight of Ice, Snow or Sleet; or
- c. A neighbor’s tree(s) felled by a Peril Insured Against under Coverage C; provided the tree(s) damages a covered structure.

The \$500 limit is the most we will pay in any one loss regardless of the number of fallen trees.

In a normal loss environment this policy provision for debris removal works as intended. As an example, if a fire loss occurs, an estimate is prepared which includes debris removal cost. Once a contractor is hired to repair the structure, the settlement includes the debris removal cost as a separate line item. If the structure is a “total loss,” once the policyholder “incurs” the removal expense (depending on the policy language), it is paid up to its limits which can also include an “additional coverage” percentage amount.

But, what if a major hurricane hits a metropolitan area of Florida during this real estate crisis? Are the owners of properties going to repair/replace their property given our real estate meltdown? Are they going to incur the cost to remove or clean up their properties or are we going to see whole communities full of “walkaways?”

What then would happen to these structures? Do the banks under their mortgage clause collect the insurance proceeds, be good citizens and pay to have these properties torn down and hauled away? Alternatively, will they take the insurance proceeds including debris removal and add the insurance proceeds to their already thin balance sheets? The anecdotal evidence shows that banks and/or homeowners would take the money and run leaving innumerable hulks of properties for the cities or communities to deal with.

If the experience of our northern “rust belt” cities is any guide, my bet is the “walkaways” will be a huge financial burden on the local communities trying to recover in the aftermath of a major hurricane strike.

One would, of course, expect significant push back from insurance companies irrespective of the fact that a premium was paid for this coverage when the policy was originally purchased. If no claim is made by the property owner or a lender, the insurance companies do not have to pay this policy benefit.

Having a city or community on a policy as a **Loss Payee** for debris removal cost perhaps is unorthodox in terms of property insurance, but in our view is a worthwhile endeavor to pursue, not to mention just plain good public policy. In fact, there is some precedent for this concept as there is often coverage in homeowner policies for the cost of a volunteer fire department services to be reimbursed from the insurance policy following their services in putting out a fire.

Interestingly, the New York Times reports in an article entitled, “Allowing Towns to Tackle Blight,” (2009, April 5) that there is a bill in the New York State Legislature that, “would allow municipalities to clean up unsightly foreclosures, issue violations and recoup the costs from lending institutions.”

Having insurance companies pay under coverage that was purchased for blighted and unsightly property damaged by a covered insurance peril does not seem unreasonable given this national trend.

In closing, are there any good arguments as to why cities or communities should not be made **Loss Payees** for debris removal in the event the property owners and lenders abandon and walk away from properties following a covered loss? In our view, this makes good sense, and the debate should begin sooner rather than later as it appears that this real estate meltdown is going to continue for some time.

With the very real possibility of a **BIG ONE** hitting a large metropolitan area of our state, we can, through proactive steps taken now, help to mitigate the hazardous and unsightly aftermath. One hopes that all interested parties would participate in this debate so that Florida continues to be known as the "Sunshine State" and not the "Walkaway" State.

Respectfully,

A handwritten signature in blue ink, appearing to read "Charles R. Tutwiler".

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