Insurance Woes Plague Apartment Landlords

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Just about everywhere landlords look these days, they see the same thing: the makings of a lawsuit.

The categories of potential liabilities for commercial real-estate owners -- especially for apartment landlords -- are growing, as are the number of tenant claims for harm or injury. And that is helping to bump up insurance premiums for apartment landlords. Premiums jumped an average 60% to 70% in 2001 from a year earlier, and 50% to 100% for policies expiring at the end of 2002, according to insurance broker Marsh, a unit of Marsh & McLennan Cos., New York.

So far, landlords' increased costs for insurance haven't necessarily been passed on to tenants. That's because apartment landlords don't typically charge residents specifically for insurance expenses as, say, an office owne would. They can always raise tenants' rents to offset expenses, but for now, they're more concerned about a softened rental market and filling empty units.

"The level of discounting and concessions going on now to get the units occupied is still pretty significant," says Robert Stevenson, an apartment real-estate analyst at Morgan Stanley in New York, "so it's pretty hard right now to pass the costs through."

Dealing With the Mold

Perhaps nowhere is the growing liability problem more apparent than with mold. Last year, the number of mold claims were up threefold from 2000, with the problem particularly acute in California, according to the Insurance Information Institute, a New York-based trade association that represents the property/liability insurance industry.

The fungal growth, found in damp or wet conditions, has been linked to health problems. There are about 8,000 to 10,000 lawsuits pending nationwide for mold litigation, insurers estimate. In December, about 500 tenants of an apartment complex in New York, who alleged that mold exposure caused health problems, settled a suit against the building owner for a reported figure of as much as $1.8 million. Last November, a jury in Sacramento, Calif., awarded a family living in an apartment complex $2.7 million for health problems allegedly caused by mold exposure. The landlord is appealing that decision. Insurers estimate they paid out $670 million last year for mold-related property damage in Texas alone.

Mold had been excluded from policies except when it resulted from the accidental discharge or overflow of water or steam or windstorm, according to the Insurance Services Office Inc., a Jersey City, N.J., provider of statistical data for the property-casualty insurance industry. But now, insurers are increasingly excluding mold from their policies altogether, regardless of the cause, and, in effect, shifting the tab to landlords. More than 35 states have allowed insurance companies to exclude mold from homeowner and commercial insurance claims. If insurers stop offering coverage on mold, apartment landlords will either have to spend more to beef up their mold-mitigation programs, pay out a lot in litigation expenses -- and possibly settlements -- or all of the above.

To be sure, insuring commercial real estate became more expensive last year, for office landlords especially, after Sept. 11. But real-estate executives say insurance costs already were skyrocketing and the terrorist attacks just exacerbated matters. In fact, many apartment owners argue they shouldn't have to buy terrorism insurance because apartments generally are considered low-probability targets. A few lenders have been requiring that apartment owners obtain terrorism insurance, says the National Multi Housing Council, a Washington, D.C., trade group.

Premiums in general rose before Sept. 11 in part because of the dramatic increases in liability claims, as well as insurers' poorer investment returns. What's more, some insurers, citing heavy losses, decided to exit the multifamily-insurance business, reducing the number of carriers. Less competition is allowing some insurers to raise rates.

In 1999, the cost of liability insurance for an apartment property averaged $20 per unit with no deductible required, according to Eric Schake, a managing director with Marsh, the world's largest insurance broker, based on revenue. Marsh insures about 30% to 40% of the real-estate industry in North America. So a company with a portfolio of 5,000 units, for example, would pay a premium of $100,000. Nowadays, that cost averages $45 to $50 per unit, and requires a minimum $5,000 deductible. The average deductible is closer to $25,000, Mr. Schake says. That same company would now pay a premium of $250,000 or more.

Expanding Exposure

Apartment landlords also blame increases in their premiums on the expanding definition of liability and the boom in the personal-injury law business, which they say has thrived on juror sympathy. The average jury award in a premises-liability claim, which refers to harm or injury on the site of any commercial real-estate property including apartment buildings, grew to $698,206 in 2000 -- the latest data available -- from $350,947 in 1997, according to Jury Verdict Research, Horsham, Pa., which tracks awards.

Meanwhile, landlords and insurers are watching how a recent wrongful-death suit filed against the owners of the San Francisco apartment building where a woman was mauled to death by two dogs in a hall last year plays out. Insurers may take a tougher stance on dogs.

"Insuring apartment complexes that allow certain breeds of dog could produce liability claims far in excess than what had been previously contemplated," says Robert P. Hartwig, chief economist with the Insurance Information Institute.