



Understanding insurance vocabulary in loan transactions

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This article discusses the importance of understanding the vocabulary of insurance (eg, the various coverages required by lenders and the applicable terms and conditions required in loan documents), particularly as it applies to insuring collateral in commercial loan transactions.¹

The current global property and liability insurance marketplace has been in a 'hard market cycle' since 2019, causing limits and coverages to be scaled back dramatically with unusually steep rises in deductibles and premiums. There is much less market capacity than has been seen in the last 5 years and many insurers are now no longer accepting classes of businesses in which they were considered the niche players. Insurers have completely left various lines of business due to incredibly high loss ratios, much of which can be traced to natural disasters such as historic flooding, hurricanes, extremely severe winter storms and wildfires.

Due to this volatility in the marketplace, obtaining and maintaining appropriate insurance coverages (for terms, conditions, limits and deductibles) is rising to the forefront of transactions. If the *proper* insurance coverages are in force with *solvent* carriers, then a loss, while undesirable, should not result in significant economic loss for either a lender or a borrower in a commercial loan transaction. In order to achieve this, however, it is important to

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understand the vocabulary of insurance, particularly as it applies to insuring collateral in a commercial loan transaction. Much of the following is applicable world-wide, though is geared towards terminology from the United States.

Unfortunately, in many loan transactions, insurance is still often viewed as a low-priority item. The parties often add a boilerplate insurance provision into the agreement and go on to more important subjects. Moreover, many lenders and borrowers simply assume their brokers and risk managers have obtained or will obtain the requisite coverages without even reading the policies. Our experience has shown us that many brokers and risk managers never even bother to examine the policy wordings, simply accepting boilerplate language without reconciling the realities of the insurance agreements in loan documents. In light of current conditions, ‘boilerplate language’, while certainly a starting point, should not be considered appropriate without a full review of the unique situation of every loan including geographic area and any special hazards that may or reasonably could exist.

The use of boilerplate language typically does not cause any trouble as long as the fundamental assumption of a real estate loan, that the borrower’s building will continue to exist, remains true. However, after a fire or other loss affects a borrower’s building and undercuts a borrower’s ability to produce rental income, there is often finger-pointing and litigation. Unfortunately, often the situation is resolved by a judicial determination that the loss was wholly or partially not covered by valid and collectible insurance.

An example of the types of problems which can occur is well illustrated in *Ruffin Road Venture Lot IV v Travelers Property Casualty Company of America*.² This case involved a property insurance policy covering risk of loss to a commercial building which suffered significant damages from a broken water pipe running underneath the property. Although the insurance company paid out for the cost of repairs, it subsequently refused to cover the cleaning costs, repair to the HVAC system, and loss of business income as a result of the incident. The court held that water leaking into the building from underground was not a covered cause of loss and, therefore, granted summary judgment regarding cleaning costs. However, coverage for cleaning and repairing the HVAC unit was granted, as the court said that it did not fit into the exclusions of the policy. Loss of business income was excluded by the court because of a failure to present evidence of lost income.

In order to achieve the most appropriate terms, conditions and coverages for a transaction, it is important to understand the vocabulary of the realm of insurance, particularly as applied to insuring commercial loan transactions. Without an understanding of these matters, it is difficult to decipher the insurance policies’ terms and, moreover, to identify possible problem areas.

In this article, we provide explanations of the basic terms and insurance provisions in the context of commercial loan transactions.

2 2011 WL 2463291 (SD Cal June 20, 2011).

I Basic insurance terms

A Insurable interest

The party being protected by the insurance must either own the property, have a substantial economic interest in the property, or be a party that would suffer a financial or other loss in the event of loss or damage to the property. In other words, the party claiming an insurable interest must meet three criteria: there must be an actual interest, a lawful interest and a substantial economic interest. In many loan agreements, the bank reserves the right to procure insurance if a borrower fails to do so. It is the insurable interest that allows the bank to do so.

B Responsible insurance carriers

The language of loan documents often requires that insurance policies be issued by 'responsible insurance carriers'. This is a somewhat amorphous phrase which allows too much leeway. Both borrower and lender should be satisfied that there are no worries about the insurance carrier's solvency. The parties should have the suitability of the carrier approved by their brokers and/or their risk managers, professionals employed by a party to analyse that party's insurance needs and arrange for the purchase of the required insurance.

As a rule of thumb, a domestic insurer should possess a minimum rating of A in the most current annual edition of *Best's Insurance Reports*, published by AM Best Company, Inc. *Best's* provides two ratings: a letter rating and a roman numeral classification. The letter classification, ranging from AA+ to F, includes many qualitative and quantitative factors of an insurance company's financial condition and operating performance. It considers liquidity, profitability, capitalisation, spread of risk, reinsurance, diversification, loss reserves, surplus adequacy, management experience and market presence. Any rating from B to F is considered vulnerable. The roman numeral classification, ranging from I to XV (smallest to largest), is based on policy holder surplus. Keep in mind that an A rating in *Best's Insurance Reports* is only a minimum level of acceptability, and the fact that a carrier has such a rating should not end the analysis.

Best's also evaluates foreign insurers in its non-US edition, and *Assecuranz Compass* is a German publication which provides information about insurance companies all over the world. Non-US insurers should also be included in the Non Admitted Insurers Quarterly Listing published by the International Insurers Department of the National Association of Insurance Commissioners (NAIC).

Standard and Poor's (S&P) analyses available financial data provided by the NAIC to determine a qualified solvency rating. S&P analyses the claims-paying ability and potential solvency of a number of insureds throughout the country. However, insurance companies must voluntarily submit to S&P scrutiny. The claims-paying ability of S&P ratings range from AAA to EEE to R. AAA is the best while EEE is extremely vulnerable. R means regulatory action. While the S&P ratings are not as clear as Best's, S&P is the major rater for CMBS loans.

Under certain circumstances, a carrier not meeting a minimum level of acceptability (eg, an A rating in *Best's*) might still be in excellent financial health and would be an acceptable carrier. This, once again, is a determination for the brokers or the risk managers. Both lender and borrower should, of course, be concerned with more than the acceptability of the insurance carrier. The face amount of the policy, and perils protected against thereunder, should also be reasonably satisfactory.

C Non-US insurers

Although there are lists and ratings which companies may find useful in evaluating the acceptability of a non-US carrier, one should deal with a knowledgeable broker who knows the insurance companies on an up-to-date and personal basis, especially when dealing with non-US insurers.

Lloyd's of London is the largest insurance market in the world, covering insurance and reinsurance. Insureds can feel confident because Lloyd's is a market, rather than a company, where over 50 agents and 80 syndicates accept risk brokered by Lloyd's. There is extensive and elaborate security behind Lloyd's practices which helps protect insureds.

D Coinsurance

Many policies contain a *coinsurance clause* which provides that if a particular property is not insured to at least a specified minimum percentage of its full insurable value, the insured may become a coinsurer with the carrier in the event of a partial loss. Under a standard coinsurance clause, if a property is not insured to at least a certain amount of its value, eg, 80%, then in the case of a partial loss, the insurer will not be liable for a greater proportion of any loss than the amount insured bears to 80% of the actual value for which the property is insured. In the case of a total loss, however, the insured would recover the full amount for which he has insured the property.

The reason many insurers include coinsurance clauses in their policies is to encourage insureds to purchase insurance up to the full value of their properties. Since most losses are for far less than the total value of the property, without a coinsurance clause, an insured might be tempted to insure only up to a small fraction of the property's value. In New York and other states, insurers are permitted, but are not required, to add a coinsurance clause as an endorsement to the standard fire policy.

Whether or not a particular property is adequately insured will be determined at the time of loss. Therefore, periodic appraisals are essential, especially in an inflationary market, to protect against the possibility of the insured becoming a coinsurer, and it is suggested that such appraisals be made at least every 2 years. There are other methods available to protect against the possibility of coinsurance including:

- agreed amount endorsement;
- inflation guard endorsement; and
- blanket insurance.

Generally, property owners would be best advised to procure for their policies either an agreed amount endorsement or an inflation guard endorsement, whichever is applicable in that particular factual circumstance. They are usually available in connection with blanket coverage, but are also, to some degree, available on individual properties. Whether or not such an endorsement will be given on a single property is a function of the insured risk involved and is also often based on an arbitrary decision by the carrier. A lender can require, as in the model language, that insurance coverage contain an agreed amount coinsurance waiver or other protection against coinsurance.

The operation of a coinsurance clause can be illustrated by the following example: Suppose a property worth \$200,000 is insured for \$100,000 (with no deductible) and it suffers a loss of \$20,000. If the policy does not contain a coinsurance clause, the insured would recover the full amount of the loss because the entire amount of the loss was within the policy limits. However, if the policy contained an 80% coinsurance clause, this clause would be activated because the property was not insured to 80% of its value or \$160,000. The insured would recover only \$12,500 because the property was only insured for 50% of its value ($\$20,000 \times \$100,000/\$160,000 = \$12,500$).

E Agreed amount endorsement

This form of endorsement is essentially a waiver of the coinsurance provision by the carrier, whereby the carrier agrees to be bound to a specific value for the insured property. Once the value is set, in the event the property appreciates, the carrier is estopped from asserting coinsurance. Therefore, in the event of loss, the insured is guaranteed recovery of the agreed amount. In order to obtain an agreed amount endorsement, the insured must procure a minimum level of insurance and may be assessed a fee for such coverage.

A coinsurance waiver could also be in the form of a provision that the coinsurance clause does not apply if the total loss does not exceed a stated amount of the sum (as a percentage) or a stated sum. This eliminates the need to determine whether or not the insured has complied with the coinsurance clause where only very small losses are involved.

F Inflation guard endorsement

This endorsement is used principally in connection with single locations and operates by automatic increases in the face amount of the policy. These increases are usually keyed to the inflation rate, but can also be done on the basis of a flat predetermined rate.

This endorsement will not necessarily prevent an insured from being underinsured although like the agreed amount endorsement, it will generally prevent a coinsurance deficiency. Under most policies, if the insured purchases an inflation guard endorsement and the face value of the policy subsequently becomes inadequate at the time of the loss to fully compensate the insured for the loss actually sustained, the insurance company cannot avoid or diminish payment by asserting that the insurance is subject to a coinsurance penalty. The insured may not receive full restitution because it

simply does not have enough insurance (eg, the amount of the loss could outrun the limit in the policy, but the insured will not become a coinsurer on the loss).

Unlike the agreed amount endorsement, however, there is always a charge for the inflation guard endorsement, and it takes the form of an increase in the premium payable for the particular policy. The increase is determined on the basis of the adjustment made to the face amount thereof.

G Blanket insurance

This form of insurance covers several properties simultaneously, either more than one item of property at a single location, or one or more items of property at different locations. Generally, the face amount of the blanket policy is equal to 90% of the aggregate insurable value of the properties. The principal advantage of blanket insurance is that the entire face value is available to cover losses sustained by any one individual property, thereby dramatically reducing the possibility of becoming a coinsurer on the loss pursuant to a valid coinsurance clause. An even more effective method of avoiding coinsurance problems is to obtain blanket insurance coverage with an agreed amount endorsement as to each individual property. This provides complete protection in that the insured has both the sliding protection of blanket coverage and the stopgap protection of an agreed amount endorsement.

Certain insurers that have large capacity do still exist (including Factory Mutual Insurance Company and Zurich Insurance Company). These specific insurers are capable of placing full limits on large programs. Most large blanket programs have found it to be more cost effective to build limits utilising groups of insurers that participate either in stacked layers or quota share the program limits. Given the current state of the property marketplace, this is commonplace.

In blanket insurance, as in other forms of insurance, it is always important to keep the insured property accurately valued to protect against activating the provisions of a coinsurance clause. However, if IRI or AFMS is the insurer, the parties can be fairly certain that the properties will be accurately valued as well as being well-maintained, good properties, ie, so-called highly protected risks. These highly protected risk properties are usually well-sprinkled in addition to being subject to frequent inspections by the insurer's field engineers and ground safety personnel who routinely make recommendations concerning maintenance and safety of the insured property. Values for the properties are usually established on a yearly basis on the anniversary date of the policy so that any increase, or decrease, between valuations is generally not excessive. New additions made during the year and not reported until the anniversary date will not affect the insurance in any way. Such changes are contemplated by the blanket coverage, and, to the extent there is an agreed amount endorsement, the blanket limit is determined.

H Replacement cost

Replacement cost is a basic principle of property insurance. Replacement cost coverage allows the insured to rebuild the same structure without significant additional funds. Under all forms of coverage, if the insured elects not to

rebuild, it will receive only actual cash value, which can be substantially less than replacement cost when depreciation is deducted therefrom. Alternatively, a policy can be written initially on an actual cash value basis. Generally, this is only where the insured property is an older building, the replacement value of which is difficult to ascertain.

I Actual loss sustained

Many policies for Loss of Business Income are written on an actual loss sustained basis. While there is no limit shown in the declarations for actual loss sustained, this does not mean an unlimited source of payment. The loss must be proven and the amount paid is limited to what is so proven.

J Seismic study or report (Probable Maximum Loss study)

A seismic study report provides an assessment of the seismic exposures of a specific location. The most customary results provided are Scenario Expected Loss (SEL), which most times equates to what was formerly known as Probable Maximum Loss (PML), and the Scenario Upper Loss (SUL). This study also provides details on the specific seismic zone and types of hazards the property is prone to experiencing.

K Moral hazard

In the insurance context, moral hazard can be defined as the risk that the insured will destroy, or permit to be destroyed, the insured property for the insured's wrongful gain at the expense of the carrier. In property insurance, moral hazard refers to arson, which is not covered under any policies. Arson is strictly defined in policies and case law as the insured setting fire to its own premises as opposed to incendiarism, ie, a third party setting fire to the insured's premises.

Moral hazard has become one of the most important factors in insurance, largely because insurance is based on faith. An insured is often taken at its word as to the subject of the insurance, both as to the existence and the amount. The insurer does not know, and often does not have the means to determine, the accuracy of the insured's statements. Therefore, the insurer places a great deal of faith in the insured's representation that the building exists, the goods have been shipped, and so on. However, if the insured has made a material misrepresentation on its application for insurance coverage, that misrepresentation will generally invalidate the coverage. In order to comprehend the difficulty of insurance companies making regular property inspections, contemplate the number of properties insured annually and the diverse locations in which they are situated. If inspections are made once in 3 years, the insurer is considered to be inspecting frequently.

L Reinsurance

Often used, but not always understood, reinsurance is a transaction whereby the insurer (known in the reinsurance context as a cedent), accepting a risk

(the ceded risk) from an insured, itself insures all or a portion of that same risk with another insurer known as the reinsurer. In its simplest terms, reinsurance can be described as ‘insurance for insurance companies’. There are many reasons why a direct insurer may wish to procure reinsurance. For instance, the direct insurer may seek reinsurance in order to mitigate its potential exposure in case of substantial losses on a specific property or group of properties. Thus, it is not surprising that reinsurance is particularly common where there is a highly valued property in a high-risk area.

As a matter of law and practice, the direct insurer is under no obligation to disclose to the insured that the risk in question is being reinsured, or who the reinsurers are. More often than not, an insured does not know whether its insurer has reinsured a portion of its policy. Since the insured’s contract is with its direct insurer, the fact that all or part of the risk has been reinsured does not affect the insurer’s relationship with its insured. The reinsurance relationship does not create privity between the original insured and the reinsurer. The insurer must pay its insured under any circumstance. Normally, the original insured cannot bypass the insolvent cedent and collect directly from the reinsurers, unless there is specific contract wording giving the cedent that right. Such a contractual right to collect from a reinsurer is often called a ‘cut through’ provision. When the insured has concerns about its insurer’s solvency, then the insured has particular reason to be interested in the reinsurance arrangements. There are two basic kinds of reinsurance: treaty and facultative.

1 Treaty reinsurance

Treaty reinsurance is an agreement between two or more insurers whereby the direct insurer agrees in advance to cede certain business to the reinsurer and the reinsurer agrees in advance to accept such business. In treaty reinsurance, subject to complying with the terms of the reinsurance agreement, the underwriting decision is solely that of the direct insurer, and the treaty dictates which business is to be reinsured. There are two main types of treaties, which can be limited to one type of coverage or can be multi-line:

- *quota share treaties* where the reinsurer reinsures a set percentage of the business included in the treaty (eg, its liability coverages); and
- *excess treaties* where the reinsurer reinsures the policies in excess of a certain limit (eg, all exposure over \$2 million per policy).

2 Facultative reinsurance

Facultative reinsurance, in contrast, is specific insurance. It involves one insurer asking a prospective reinsurer whether it wishes to reinsure a specific risk. The prospective reinsurer is not required to accept any particular reinsurance and can decline any risk or agree to reinsure only a certain percentage. For example, will reinsurer (R) reinsure the earthquake coverage of insurer (I) for a \$250-million newly constructed mall (M) that was built right on top of the San Andreas fault?

3 Liability and the cut-through endorsement

As previously mentioned, a cut-through endorsement enables the insured to proceed against the individual reinsurers for their respective portions of the

risk when the direct insurer becomes insolvent or refuses or is unable to pay. It is particularly valuable under these circumstances because the insured has two potential sources of compensation — the direct insurer and the reinsurers. With or without this endorsement, however, the direct insurer is always liable for the full amount of any valid claim. If the direct insurer becomes insolvent and there is no cut-through clause, the reinsurer will make its payment to the domiciliary receiver.³ The insured will first have to seek payment from the guaranty fund.⁴ If the guaranty fund cannot pay the claim in full because it is constrained by statutory limits as to the maximum amount it can pay on any one loss, the insured must seek recovery from the domiciliary receiver. Therefore, while cut-through endorsements are often not available, they should be obtained whenever possible. Although a cut-through endorsement is likely unnecessary with certain A+ direct insurers and underwriters at Lloyd's of London, with other less solvent direct insurers, one should endeavour to obtain it. An insured should ask its broker or risk manager whether it should insist upon a cut-through endorsement.

M Captive insurer

A captive insurance company is a company organised for the primary purpose of insuring or reinsuring the exposures of its parent organisation. An association captive is a jointly owned insurance or reinsurance company, affiliated with a group of entities, all belonging to a particular trade group or professional society, usually having common insurance needs. There are several forms of captive insurers:

- Single owner captives: A pure captive insurer, also known as a single parent captive, is traditionally defined as a subsidiary insurance company whose ownership is held by a parent corporation, and whose sole purpose is to insure the risks of that same parent corporation and other affiliates.
- Group captives: Group-owned captives several companies who have joined together to form a single insurer to pool their risks.
- Rent-a-captive: This occurs when a specific captive insurer 'rents' the use of itself to any outside organisation. The 'renter' then is able to obtain the benefits of using a captive without the significant time and financial resources associated with starting and maintaining their own captive.
- Protected cell companies: This is a captive that has one single core company but has various 'cells' (similar to affiliated companies or

³ When an insurer is liquidated or rehabilitated, its affairs will be administered by the insurance commissioner in its state of domicile. In this capacity, the insurance commissioner is acting as the domiciliary receiver.

⁴ A guaranty fund is a creature of state statute and is funded by carriers licensed in a state. When a licensed insurer is liquidated, the fund pays the claims of the bankrupt carrier, subject to limitations as set forth in the statute. However, alien insurers are not required to participate in state guaranty funds in most states and, as such, policyholders do not receive guaranty fund protection in the event of insurer insolvency.

subsidiary companies) that are completely independent (including financially and managerially).

- Special purpose captive: This is a captive that is usually run by one parent company to provide a very specific risk management function (such as providing insurance for niche exposures).

A captive is also formed to:

- provide for a stable source of insurance (for terms, conditions, limits, deductibles and premiums);
- supply coverage that may be otherwise unavailable with tailor-made policies (especially true for captives in the pharmaceutical arena as well as those in highly specialised fields since as mining or with unique exposures);
- assist with the reduction of the cost of risk over time; although, intensive risk management efforts are required, since the insured is its own insurer, the captive can cut through and/or reinsure to others; and
- act as a profit centre for its founding group. However, the amount of 'profit' depends on the lines of coverage and the management of the risk and exposures.

Although the initial growth in the number of captive insurers took place in offshore jurisdictions such as Bermuda and the Cayman Islands, changes in the insurance laws of several states, such as Colorado, Tennessee, Vermont and, recently, Delaware, have facilitated the formation of group and single-parent captives in domestic jurisdictions.

The use of captives grew in response to increased insurance costs imposed by commercial insurers or the inability to obtain certain coverages from commercial insurers. Many companies decided to maintain their insurance affiliates even after the marketplace became more favourable for the purchase of direct coverages because of perceived risk financing cost savings derived from cash flow benefit, the lower cost of coverages in the reinsurance market, and the reduced overhead burden imposed in premium charges by commercial insurers. Today, in an increasingly tight insurance market, we have found many companies again desirous of forming captives.⁵

II Types of insurance coverage

A Builder's risk insurance (BRI) and broad form fire insurance (FI)

There are three forms of loss coverage for building and personal property: basic form, broad form and special form. Special form provides the broadest applicable coverage and it is most desirable. Special form covers everything unless specifically excluded (and is still, on occasion, referred to as an all-risk form), while basic form covers only a specific list of perils (eg, fire, lightning, windstorm or hail, explosion, smoke, vandalism, aircraft or vehicle collision,

⁵ The US Tax Reform Act of 1986, which extensively amended our Internal Revenue Code, had significant impact on captives.

riot or civil commotion, sinkhole collapse and volcanic activity). Broad form includes the coverages from a basic form policy and includes further coverages; however, it also includes a long list of exclusions.

BRI is a special type of property insurance which indemnifies against damage to buildings while they are under construction. In addition to protection against enumerated perils which result in damage to the structure while under construction, BRI often covers losses resulting from damage to stored materials and temporary structures owned by the insured and located on the property which are incidental to the construction. However, in the current marketplace, one must pay particular attention to all the coverages, limits and exclusions as it is becoming much more common to be required to request specific coverages with specific limits rather than 'bucket' limits.

Caution should be taken whenever BRI and FI are used because of the coverage gap that can result with such coverage. BRI begins when construction commences (usually at the moment there is value at risk, not at excavation stages) and typically is terminated when the subject property is enclosed from the elements (as the costs of FI are much lower than BRI and it is generally deemed more cost effective to move a project off of construction insurance, such as BRI, as quickly as possible. FI, though, may not begin until sometime thereafter unless there is careful coordination. Some insurance carriers will not commence FI until a certificate of occupancy (or its equivalent) has been issued by the local government. Early commencement of FI should not be at all burdensome to the insured because of the minimal cost of such protection. In addition, it is preferable to obtain all policies from the same insurer to avoid the conflicting claims of carriers on a given loss. BRI should also be written with a permission to occupy clause that has no limitation, which would allow for the early occupancy of the project while the BRI policy is still active. The marketplace is shifting to not allow this for all projects (and may limit it to 120 days or less) so one must be mindful this is reviewed.

BRI should be written on a completed value form wherever possible. If it is written on a reporting basis instead and the insured does not notify the insurer of the construction status (usually monthly), the coverage could cancel or, at a minimum, may not extend to work performed within the prior 30 days (or the reporting period). When written on a reporting basis, if the insured does timely report the construction status, that enables the insured to reflect the increase in the property value in face amount of the policy. Failure to report can result in coinsurance problems. BRI can also be written on a completed value basis where the face amount of the policy equals the contemplated value of the building when completed.

B Difference-in-conditions insurance (DIC)

DIC covers virtually all risks not included in broad form FI and is considered to be gap insurance. Generally, DIC includes protection against earth movement, earthquake (EQ), earthquake sprinkler leakage, landslide, flood and other unusual accidental occurrences, though some of these perils may be excluded. If used for flood, special attention must be paid to back-up of sewers and drains or water main breakage. For earth movement type losses, attention

must be given to which policy is covering items such as earthquake sprinkler leakage (as it is quite common for the property policy to cover that but the DIC covers the EQ damage).

An insured would be best advised to insist on FI and DIC coverages commencing with the time and date BRI is terminated, or to request that BRI be extended until the commencement of FI.

C All-risk insurance

All-risk insurance covers each and every loss except for those specifically excluded. If the insurance company does not specifically exclude a particular loss, it is automatically covered, making all-risk insurance the broadest type of property policy that can be purchased. Generally, lenders will require insurance to cover such all-risks including damage and theft, flood, earthquake, boiler and machinery, rent and business interruption. In the current marketplace, you cannot purchase this 'off-the-shelf'. It is now a terminology that refers only to manuscripted policy forms. 'Special form' policies are now considered as close as possible to all-risk insurance.

D Property damage

The borrower must obtain coverage insuring against damage or theft to property that it owns, eg, machinery and improvements, and should ensure that there are no exclusions in the policy which could lead to an uncovered loss. Particular attention should be given to any exclusions regarding water damage, as many property policies do not cover damages caused by seepage, except by special endorsement at an additional premium.

Many insurers cannot provide the entire limit for so-called trophy buildings or large portfolio accounts. Coverages are thus often built with a primary layer (which may be one or more insurers) and then excess layers with multiple insurers (and many times multiple insurers within a layer, known as quota-share). There are even more complicated structures that require what is known as a 'mud map' to explain which insurers are participating, how they are participating and how the entire program adds up. Insureds need to pay particular attention to any endorsements being added by individual insurers to determine if there are gaps in coverage (which may vary from layer to layer).

E Flood insurance

Lenders may require that a borrower obtain flood insurance if any portion of improvements on the collateral, or the collateral itself, is located within an area designated as 'flood prone'. Floods are defined under the National Flood Insurance Program (NFIP) as a general and temporary condition of partial or complete inundation of two or more acres of normally dry land or of two or more properties (at least one of which is the policyholder's property) due to: (i) an overflow of inland or tidal waters; (ii) an unusual and rapid accumulation or runoff of surface waters from any source; (iii) mudflow; or (iv) the collapse or subsidence of land along the shore of a lake or similar body

of water as a result of erosion or undermining caused by waves or currents of water exceeding anticipated cyclical levels that result in a flood as defined above.

Flood insurance policies are issued by the Federal Insurance Administrator pursuant to the National Flood Insurance Act of 1968. Since 1979, the program has been administered by the Federal Emergency Management Agency. The limits of coverage are: (a) for commercial properties, \$500,000/\$500,000; (b) for residential properties (other than condominium units), \$250,000/\$250,000; and (c) for condominium units, \$250,000 per unit.

Excess flood insurance can be located within a property insurance policy or a special excess flood policy. These coverages can be layered and/or quota-shared, as well. The insured needs to pay particular attention to avoid gaps that could be caused by various insurers adding different endorsements.

F Earthquake insurance

Standard property insurance does not cover damage resulting from earthquake or volcanic eruption. Therefore, such coverage can be purchased as an endorsement to many property policies. If there is a lapse of at least 72 hours (now more commonly 168 hours) between earthquake shocks, then each loss by a given earthquake is subject to a new claim. However, earthquake losses often exclude fire, explosion, flood or tidal wave. Therefore, borrowers must be certain to obtain additional coverage for such losses and obtain an endorsement known as a joint loss agreement, which facilitates payment of insurance proceeds when there are two different carriers for the property and the earthquake coverage and there is a disagreement as to the amount of loss to be paid by each carrier.

G Boiler, air-conditioning and machinery insurance or equipment breakdown (BACM)

Since many property policies exclude losses due to explosions by boilers, air-conditioning equipment and machinery (with the exception of special form insurance which usually includes or provides the option to include such losses), coverage for these generally must be purchased separately. There are various types of losses which can be insured against, including property damage and bodily injury liabilities. The borrower is also responsible for BACM coverage if it has a heating unit or tailor equipment.

The typical BACM policy provides coverage only where there has been an accident. An accident is defined as the 'sudden and accidental breakdown' of the boiler, air-conditioning equipment or machinery. There is a great deal of case law on what constitutes sudden and what constitutes accidental in this context. Generally, the courts have interpreted sudden to mean unforeseen rather than instantaneous. Additionally, the typical BACM policy contains a large number of exclusions (eg, corrosion, wear and tear).

Where an outside fire causes a steam boiler to explode, a dispute will often arise between the fire insurer and the steam boiler insurer as to their respective liability and/or proportional responsibility for the loss or damages. Unfortunately, however, a dispute such as this can delay claims payments while the insurers engage in protracted litigation. Here again, borrowers

should obtain a joint loss agreement to facilitate payment of insurance proceeds when there are two different carriers and there is a disagreement as to the amount of loss to be paid by each carrier.

In response to the vast amount of seemingly unproductive litigation between fire insurers and boiler, air-conditioning and machinery insurers, some insurers are now providing all-risk property damage policies which cover boiler, air-conditioning and machinery losses. The insured should note, however, that all-risk is merely a term of insurance jargon and does not mean that every loss will be covered. Rather, as in all cases, the lender and the insured must examine the policy wording to determine if it provides adequate protection.

There are many additional types of coverages (which include wind or hail vs named storm, law and ordinance, and, of special concern, insurer underwriting moratoriums especially related to storms) that are beyond the scope of this article but should be reviewed carefully when the exposures exist.

H Rent insurance (RI)

RI is based on two potential circumstances:

- A landlord loses rent after casualty to property, if there is anything less than a full obligation on the part of the tenant to pay rent during restoration.
- The tenant may be obligated to continue to pay rent without abatement after casualty to property and/or be subject to increases in rent after relocation during mandatory restoration periods.

In either event, RI is necessary to protect against the loss incurred and should cover at least 1 year of losses (though, in special situations of trophy locations, 24 months may be more prudent). In most cases, extended period of indemnity coverage should be obtained (this can range from 90 days to 365 days and provides extra protection from when a location is repaired or replaced until when it is back at the occupancy level preceding the loss — subject to the length of time insured).

I Business interruption insurance (BII)

BII protects an insured from loss arising out of the cessation of operations and is particularly important to landlords, manufacturers and retailers. A condition precedent to any payment under BII is the insured's commitment to rebuild or restore. BII claims are among the most difficult to adjust because of the problems encountered in determining the cost and lost profits which constitute the loss. Customarily, coverage would be provided on a gross earnings form and would include an extended period of indemnity.

J Commercial general liability insurance (CGL)

Accidents can occur in numerous ways at an insured's premises. Primary causes include:

- improper maintenance;
- injury caused by machinery; and
- injury caused by employees, agents or contractors (however, this does not include employment practices liability, sexual harassment and communicable diseases, which are specialty insurance coverages).

A CGL policy covers liabilities incurred by reason of injuries to third parties subject to certain stated exclusions. It is important for the insured to:

- examine its policy carefully to determine whether any policy exclusion would leave it, by virtue of its particular business, exposed to significant liabilities (eg, most policies exclude environmental impairment liability, and in today's tight insurance market, it is difficult and expensive to purchase coverage for this type of liability) and a great deal of underwriting information is required about the specific location;
- purchase endorsements eliminating any such exclusion. In situations where the exclusion is significant and the CGL insurer will not provide an endorsement, the insured should look into the possibility of buying a separate policy to cover the excluded risk; and
- make certain, where the insured has more than one location, that any coverage should be written on a 'per location' basis wherever possible so the policy covers all locations.

Often times, when an insured is sued, its major worry is not the potential liability, but the legal fees incurred in defending the suit. Under a CGL policy, when a lawsuit is brought against the insured and *any* cause of action alleged in the suit, if it were correct, would result in a covered loss under the policy, then the legal fees must be paid by the insurer. Thus, since the duty to defend lawsuits can encompass meritless and noncovered claims, the duty to defend is broader than the duty to indemnify. Usually, where the insurer is paying the legal fees, it will choose the law firm to represent the insured. However, if the insured is not satisfied with this firm, it should advise the insurer. If the insured has a valid rationale for its dissatisfaction, the insurer may agree to provide the insured with different counsel. Additionally, if there is one particular firm the insured generally uses, which is familiar with its business, the insured may wish to request the insurer use this firm in the event of litigation. While the insurer is not required to honour an insured's request, it may be willing to do so. Remember, even though the insurer is paying the legal fees, the defence attorney is representing the insured. Therefore, it is in the insured's interest to be properly represented in any lawsuit.

Traditionally, liability insurance has been written on an *occurrence* basis. This means that the policy will cover any claim brought as a result of an occurrence which occurred during the policy period regardless of when the insured is sued. For example, if a third party is injured at the premises in 1981 and he files suit in 1983, the policy in force during 1981 would cover this

claim. Although it is not generally used for most liability exposures, such insurance can be written on a *claims made* form. This type of policy will cover any claim first asserted against the insured during the policy year. This means that under the above hypothetical, the policy in force during 1983 would cover the claim.⁶ Claims made coverage is generally seen in connection with professional liability insurance and used when there is a medical or professional exposure as a component to the business. It is important to ensure the retroactive date is as far back in time as possible to limit any potential coverage gaps.

Generally speaking, occurrence policies are preferable to the insured because, if purchased during all the years it operates its business, it will provide continuous coverage for the insured even if the lawsuit is brought many years later. Insurers are changing to claims made forms largely because insurers writing occurrence policies are now incurring massive liabilities on policies written from the 1940s through the 1960s for slowly developing injuries, eg, asbestosis. One should be particularly careful to be certain that there are no gaps in coverage if there is a change from an occurrence to a claims made policy. Further, if a borrower has claims made coverage and ceases doing business at a location, it should purchase a policy or rider which continues coverage for incidents which may have occurred in the past, though no suit has yet been filed.

An insured should procure liability insurance in an amount appropriate for its business. In determining the appropriate amount, the insured should clarify whether the policy limits encompass both indemnity and legal expense payments, or whether the limits apply only to indemnity payments, with no limits constraining the amount of legal expenses (this is known commonly as 'defence outside the limits' policies).

K Miscellaneous insurances

There are a variety of other types of insurance a lender should make its borrower aware of and may require:

- Workers' compensation and employers' liability insurance may need to be procured depending on the rules of the state the project is located in or if, jurisdictionally, another state's rules apply to the workers. It should be noted that several states are monopolistic and the insurance would be through them directly; however, it is important in many cases to place excess coverage.
- Auto liability insurance provides coverage in case of a car accident and can cover either bodily injury or property damage.
- Disability insurance provides benefits in the event that the policyholder becomes incapable of working.
- Terrorism insurance protects against losses resulting from acts of terrorism. Due to the uncertainty and potential for huge losses as demonstrated on 11 September 2001, most insurance companies exclude

⁶ Under certain *claims made* forms, if an insured becomes aware that a claim will be made against it in the future, it can report that claim to the insurer, and the claim is deemed to be covered under the policy in force at the time of notification to the insurer.

such losses from property and casualty insurance. Therefore, such insurance can be procured as gap coverage.

L Excess and umbrella coverages

Often, an insured purchases additional liability insurance policies in either layers or quota-share fashion. This is another device which can be utilised where an insurer does not wish to provide all of the third-party coverages that the insured wishes to purchase.

The first layer of coverage is called the primary layer, and the insurers insuring this layer are called the primary insurers. The next layer of insurance is known as the first excess layer; then follows the second excess layer, and so on. One can also have multiple sharing of a layer or program, known as a quota-share. It is important for excess liability that coverage be, wherever possible, on a 'follow form' basis of the primary CGL (to prevent gaps in protection).

An insured wishes to purchase \$3 million of insurance. He may be able to procure the first \$100,000 from one carrier (the primary carrier), the next \$900,000 from another carrier(s) (the first excess insurer(s)), and the remaining \$2 million from another group of carriers (the second excess carriers). If a loss occurs, the insured first seeks payment from the primary cover; and only after the primary insurer has satisfied its obligations does the insured seek recovery from the first excess layer. The insured seeks recovery from each excess layer as the one below it is exhausted.

The insured must be particularly careful to make certain that all of the policies provide the type of coverage desired. Often, the excess policies will provide coverage at their stated limits on a *following form* basis (ie, in accordance with the terms of the primary policies). However, this is not always the case and, thus, it is not enough to examine the terms of the primary policy. Borrower and lender or their broker or risk manager should check the policy forms issued by excess insurers to make certain that there are no additional hidden exclusions or limitations of coverage which were not stated in the primary policy.

Each of the primary and excess carriers owes contractual duties directly to the insured. However, sometimes disputes develop between the coverage layers which ultimately involve the insured. In many states, not only does the primary carrier owe duties to the insured, but it also owes duties to the excess carrier.

One type of excess liability coverage which is popular today is the *umbrella policy*. An umbrella policy provides coverage which is excess to most or all of the various liability coverages which an insured might have. Umbrella coverage is a convenient way for the insured to provide that it has sufficient liability coverage. Once again, the insured should make certain that an umbrella policy essentially adopts the same terms as the underlying policies and contains no hidden exclusions or limitations on coverage.

III Insurance provisions contained in the loan agreement

A Waiver of subrogation clause

Most insurance policies effecting first-party coverage, such as property insurance, contractually provide that upon payment of the insured's claim, the insurer steps into the shoes of the insured, and thereby obtains the right, in the name of the insured, to sue the party causing the damage. This right of the insurer, which is also a common law right and sometimes a statutory right, is known as the right of subrogation. Lender's agreements routinely require borrowers to obtain a waiver of that right of subrogation from borrowers' insurance carriers. The theory underlying this requirement is that, since borrower is paying for the insurance coverage, it should submit its claim to its carrier and, upon payment of that claim by the carrier, the matter should proceed no further. One should make certain that the inclusion of such a clause in the loan documents will not be in conflict with the terms of other existing insurance policies, usually by including the phrase 'as may be applicable and available'.

B Cancellation clause

Loan agreements generally require that all policies provide that no cancellation, reduction or amendment shall be effective until at least 30 days after receipt by the lender of written notice — presumably the time necessary to cure any defaults, obtain new insurance or cause the elimination of the offending amendment. Currently, notice of material change or reduction of limits is not commercially available. Many lenders are now including the requirement of such notice to be from the borrower. Although some state statutes require only 15 days if a default involves nonpayment of a premium, time must be allowed for lender to acquire the necessary funds. More importantly, if the policy is to be cancelled for more personal reasons (ie, reasons that reflect on the quality or performance of the insured), finding substitute coverage will likely be more difficult and time-consuming.

While it is rare for a policy to be cancelled because the insured conducts a use more hazardous than that permitted under the policy, cancellation does happen where a material change in the nature of the risk occurs. It is unusual that such a situation would arise in the typical commercial operation, but problems could occur where a landlord is trying to maintain an existing policy and there is a change in the tenancy of its property. Alternatively, a more hazardous use could result where a condition of the insured property changes, eg, where the sprinkler system is no longer adequate.

Appendix A-1

Model insurance provisions for term loan⁷

1.1 Insurance. Shall maintain insurance for the benefit of the Banks as follows:

(a) Casualty; business interruption

- (i) Property insurance against loss customarily included under so called 'all risk' policies including flood, collapse, theft and earthquake, boiler and machinery, acts of terrorism, and such other insurable hazards as, under good insurance practices, from time to time are insured against for other property and buildings similar to the premises in nature, use, location, height and type of construction. Such insurance policy shall also insure the additional expense of demolition and increased cost of construction due to the enforcement of Legal Requirements regulating reconstruction at the time of rebuilding following a loss, which insurance for demolition and increased cost of construction may contain a sublimit of \$[XXXX]. The amount of such 'all risk' insurance shall be not less than 100% of the replacement cost value of the improvements. Each such insurance policy shall contain an agreed amount (coinsurance waiver) and replacement cost value endorsement and shall cover, without limitation, all tenant improvements and betterments, which Borrower is required to insure in accordance with any lease.
- (ii) If any portion of the improvements is located within an area designated as 'flood prone' or a 'special flood hazard area' (as defined under the regulations adopted under the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973), flood insurance shall be provided, in an amount not less than the maximum limit of coverage available under the federal flood insurance plan with respect to the Project. Agent reserves the right to require flood insurance in excess of that available under the federal flood insurance plan. Should the available aggregate limits of flood insurance be eroded by losses so that the remaining limits available to pay losses are less than [XX]% of the required limits, Borrower shall promptly purchase additional coverage to restore the available limit and aggregate limit to not less than [XX]% of the required amount of flood insurance. Amounts of flood insurance required by this paragraph (a)(ii) shall be solely for the protection of the improvements. If the amounts of flood insurance required by any ground lease, condominium declaration, reciprocal easement agreement, covenants, conditions and restrictions, or the like are greater than the amounts required herein, then Borrower shall maintain such higher amounts of flood insurance. If the flood insurance and associated aggregate limits are shared among other locations, then the risks associated with other locations also insured in the same policy shall be

⁷ This is a sample only and is not to be construed as being endorsed or recommended by the author. Readers are advised to consult legal counsel to devise appropriate documents for their centres.

taken into consideration in determining the amount of flood insurance to be provided herein.

- (iii) Comprehensive boiler and machinery insurance covering all mechanical and electrical equipment against physical damage on a replacement cost basis. The minimum amount of limits to be provided shall be \$[XXXX] per accident.
- (iv) Rent loss and/or business interruption insurance on an actual loss sustained basis as an extension to coverage required by (i) and (ii) above, in an amount not less than the amount of rent receivable or business income earned in an 18-month period and additionally providing a 360-day extended period of indemnity. Agent on behalf of the Banks shall be named as loss payee as respects this coverage.
- (v) During any period of repair or restoration, builder's 'All-Risk' insurance in an amount equal to not less than the full insurable completed value of the Project against such risks (including so called 'all risk' perils coverage and collapse of the Improvements) to agreed limits as Agent may request, in form and substance acceptable to Agent.
- (vi) The amount of earthquake insurance shall be based on a 'Probable Maximum Loss' Study (PML) for the Project, which must be conducted by a seismic engineering company satisfactory to Agent. The results of the PML study, on an individual location basis and for all locations insured in the same earthquake insurance policies, shall be used to determine the amount of earthquake coverage to be provided by Borrower. The amount of insurance shall be determined by adding the total expected damage to all improvements subject to a single earthquake event in a given region together with the expected loss of rental income for each property, singly and collectively, for a given regional event. Earthquake insurance shall provide a limit inclusive of rent loss for 'Very High', 'High', and 'Moderate' Hazard Earthquake Risk ratings at twice the annual rental amount. Other lower risk-rated buildings, as determined by Agent, shall provide one times the annual rental loss. The total amount of earthquake insurance in limits shall be the sum of expected property damage, reconstruction cost and rental income loss calculation. Should the available aggregate limits of earthquake insurance be eroded by losses so that the remaining limits available to pay losses are less than [XX]% of the required limits, Borrower shall purchase additional coverage to restore the available limit and aggregate limit to not less than [XX]% of the required amount of earthquake insurance. Amounts of earthquake insurance required by this paragraph (a)(vi) shall be solely for the protection of the improvements. If the amounts of earthquake insurance required by any ground lease, condominium declaration, reciprocal easement agreement, covenants, conditions and restrictions, or the like are greater than the amounts required herein, then Borrower shall maintain such higher amounts of earthquake insurance. If the earthquake insurance and associated aggregate limits are shared among other locations, then the risks associated with other locations also insured in the same policy

shall be taken into consideration in determining the amount of earthquake insurance to be provided herein.

- (vii) Environmental liability insurance against any and all claims, including all legal liability that could be imposed against Agent or the Banks to the extent insurable, and all court costs and attorneys' fees and expenses, arising out of or in connection with the presence of any Hazardous Materials at the Project, providing coverage in an amount not less than [\$_____].
- (viii) The policies of insurance set forth in the foregoing clauses (i), (iii), (iv) and (v) shall not exclude from coverage acts of terrorism and such policies, therefore, shall include 100% replacement cost insurance without co-insurance for damage to, or loss of rents from, the Project caused by terrorist activities. All policies of insurance set forth in this *Section 1.1(a)* shall have deductibles of not more than 5% of the insurable value of the Project. Should the available aggregate limits of terrorism coverage be eroded by losses so that the remaining limits available to pay losses are less than [XX]% of the required limits, Borrower shall purchase additional coverage to restore the available limit and aggregate limit to not less than [XX]% of the required amount of terrorism coverage. Amounts of terrorism coverage required by this paragraph (a)(viii) shall be solely for the protection of the improvements. If the amounts of terrorism coverage required by any ground lease, condominium declaration, reciprocal easement agreement, covenants, conditions and restrictions, or the like are greater than the amounts required herein, then Borrower shall maintain such higher amounts of terrorism coverage. If terrorism coverage and associated aggregate limits are shared among other locations, then the risks associated with other locations also insured in the same policy shall be taken into consideration in determining the amount of terrorism coverage to be provided herein.

(b) Liability

- (i) General public liability insurance, including, without limitation, commercial general liability insurance; owned (if any), hired and non-owned auto liability; and umbrella liability coverage for personal injury, bodily injury, death, accident and property damage, providing in combination no less than \$[XXXX] per occurrence (\$[XXXX] during construction) and in the annual aggregate, per location. If aggregate limits are shared among more than one location, a \$[XXXX] limit shall be obtained. The policies described in this paragraph shall cover, without limitation: elevators, escalators, independent contractors, contractual liability (covering, to the maximum extent permitted by law the mortgagor's obligation to indemnify the mortgagee as required under this Agreement) products and completed operations liability coverage.
- (ii) Workers' compensation and disability insurance as required by law.

(c) Form and quality

All insurance policies shall be endorsed in form and substance acceptable to Agent to name Agent on behalf of the Banks as an additional insured, loss payee or mortgagee thereunder, as its interest may appear, with loss payable to Agent on behalf of the Banks, without contribution, under a standard New York (or local equivalent) mortgagee clause. With respect to all insurance under *Section 1.1(a)*, no Person other than Agent shall be named as loss payee. All premiums for such insurance policies and endorsements shall be paid for (and evidence of such payment shall be delivered to Agent) not later than thirty (30) calendar days prior to the next ensuing policy year. All such policies and endorsements shall contain such provisions and expiration dates and be in such form and issued by such insurance companies licensed or authorized to do business in the State, with a rating of 'A:X' or better as established by Best's Rating Guide (or an equivalent rating approved in writing by Agent). If any insurance company issuing such insurance shall no longer have such required rating, Borrower shall, within 10 Business Days after notice from Agent, cause a replacement insurance policy(ies) to be issued by an insurance company licensed to do business in the State which has such required rating (upon issuance of such replacement insurance policy(ies), Agent will simultaneously release the insurance policy(ies) being replaced). If any insurance company issuing such insurance shall enter into any form of regulatory or governmental receivership or other similar regulatory or governmental proceeding, or is otherwise declared insolvent or required to run off its insurance coverages, Borrower shall, within 5 Business Days, deliver to Agent a replacement insurance policy(ies) to be issued by an insurance company licensed to do business in the State which has such required rating. Each policy shall provide that such policy may not be cancelled or materially changed except upon 30 days' prior written notice of intention of non-renewal, cancellation or material change to Agent and that no act or thing done by Borrower shall invalidate any policy as against Agent. Borrower shall, promptly when available, deliver copies of all original policies certified to Agent by the insurance company or authorized agent as being true copies, together with the endorsements required hereunder; provided, however, neither Agent nor any Bank shall be deemed by reason of the custody of such insurance policies to have knowledge of the contents thereof. The proceeds of insurance policies coming into the possession of Agent shall not be deemed trust funds, and Agent shall be entitled to apply such proceeds as herein provided. Borrower may effect such coverage under its blanket insurance policies, provided that (i) any such policy of blanket insurance either shall specify therein, or Borrower shall furnish Agent with written statement from the insurer under such policy so specifying; (x) the maximum amount of the total insurance afforded by the blanket policy allocated to the Project; and (y) any sublimits in such blanket policy applicable to the Project, which amounts shall not be less than the amount required pursuant to this *Section 1.1*; (ii) any policy of blanket insurance hereunder shall comply in all respects with the other provisions of this *Section 1.1(c)*; and (iii) the protection afforded Borrower under any policy of blanket insurance hereunder shall be no less than that which would have been afforded under a separate policy or policies relating only to the Project. Borrower shall not take out separate insurance

concurrent in form or contributing in the event of loss with that required to be maintained under this *Section 1.1* unless Agent is included thereon as a named insured with loss payable to Agent under a standard mortgage endorsement of the character and to the extent above described. Borrower shall promptly notify Agent whenever any such separate insurance is taken out and shall promptly deliver to Agent the policy or policies of such insurance. Each insurance policy shall contain a provision whereby the insurer: (1) waives any right to claim any premiums and commissions against Agent, provided that the policy need not waive the requirement that the premium be paid in order for a claim to be paid to the insured; and (2) provides that Agent is permitted to make payments to effect the continuation of such policy upon notice of cancellation due to non-payment of premiums. In the event any insurance policy (except for general public and other liability and workers compensation insurance) shall contain breach of warranty provisions, such policy shall provide that with respect to the interest of Agent, such insurance policy shall not be invalidated by and shall insure Agent regardless of (X) any act, failure to act or negligence of or violation of warranties, declarations or conditions contained in such policy by any named insured; (Y) the occupancy or use of the premises for purposes more hazardous than permitted by the terms thereof; or (Z) any foreclosure or other action or proceeding taken by Agent pursuant to any provision of this Agreement or any of the other Loan Documents.

(d) Adjustments

Borrower shall give immediate written notice of any loss to the insurance carrier and to Agent. With respect to any loss exceeding \$[XXXX], Borrower hereby irrevocably authorizes and empowers Agent, as attorney-in-fact for Borrower coupled with an interest, to make proof of loss, to adjust and compromise any claim under insurance policies, to appear in and prosecute any action arising from such insurance policies, to collect and receive insurance proceeds, and to deduct therefrom Agent's expenses incurred in the collection of such proceeds. Nothing contained in this *Section 1.1(d)*, however, shall require Agent to incur any expense or take any action hereunder.

(e) Bank's right to procure insurance

Notwithstanding anything to the contrary contained herein, if at any time Agent is not in receipt of written evidence that all insurance required hereunder is maintained in full force and effect, Agent shall have the right (but not the obligation), upon notice to Borrower, to take such action as Agent deems necessary to protect its interests in the Project, including, without limitation, the obtaining of such insurance coverage as Agent deems appropriate, and all premiums paid and expenses incurred by Agent in connection with such action shall be paid by Borrower and shall be secured by the Mortgage.

(f) Delivery of policies

Borrower shall promptly when available deliver to Agent certified copies (or other reasonable evidence) of the insurance policies required to be maintained pursuant to this *Section 1.1*, provided, however, neither Agent nor any Bank

shall be deemed by reason of the custody of such insurance policies or copies thereof to have knowledge of the contents thereof. Borrower also shall deliver to Agent, within 10 days of Agent's request, a certificate of each insurance carrier evidencing the coverages set forth herein together with evidence that all insurance premiums due thereon have been paid and that such coverages are in full force and effect. Not later than 30 days prior to the expiration date of each of the insurance policies, Borrower shall deliver to Agent binders of all such renewal insurance policies. Such proof of renewal insurance shall include evidence satisfactory to Agent that all insurance premiums therefor have been paid and that the insurance coverages are in full force and effect. Any certificate of insurance delivered to Agent in compliance with the requirements of this Agreement shall include a letter from the relevant insurance company confirming that the entity issuing such certificate of insurance is authorized to do so, and in delivering such certificate they are acting as an agent of the insurance company providing the coverage. If such letter is not provided, then Agent will only accept insurance company issued binders confirming that the required insurance is in full force and effect.

1.2 Use and application of insurance proceeds

All insurance proceeds shall be paid to Agent, and Agent shall apply insurance proceeds to costs of restoring the Project or payment of the Loan as follows:

- (i) if the loss is less than or equal to \$[XXXX], Agent shall apply the insurance proceeds to restoration provided (i) no Event of Default or Potential Default exists; (ii) Borrower promptly commences and is diligently pursuing restoration of the Project; and (iii) the loss is not, directly or indirectly, the result of terrorist activities;
- (ii) if the loss exceeds \$[XXXX] but is not more than [XX]% of the replacement value of the improvements, Agent shall apply the insurance proceeds to restoration provided that at all times during such restoration (i) no Event of Default or Potential Default exists; (ii) Agent determines that there are sufficient funds available to restore and repair the Project to a condition approved by Agent; (iii) Agent determines that the Net Operating Income of the Project during restoration will be sufficient to pay Debt Service; (iv) Agent determines (based upon Leases that will remain in effect after restoration is complete and the like) that after restoration (x) the Debt Service Coverage Ratio will be at least 1.__:1; and (y) the Loan-to-Value Ratio will be no more than __%; (v) Agent determines that restoration and repair of the Project to a condition approved by Agent will be completed within six months after the date of loss or casualty and in any event 180 days prior to the Maturity Date; (vi) Borrower promptly commences and is diligently pursuing restoration of the Project; and (vii) the loss is not, directly or indirectly the result of any act of terrorism;
- (iii) if the conditions set forth above are not satisfied or the loss exceeds the maximum amount specified in Section 1.2(b) above, in Agent's sole discretion, Agent may apply any insurance proceeds it may receive to the payment of the Loan or allow all or a portion of such proceeds to be used for the restoration of the Project;

- (iv) insurance proceeds applied to restoration will be disbursed on receipt of satisfactory plans and specifications, contracts and subcontracts, schedules, budgets, lien waivers and architects' certificates, and otherwise in accordance with prudent commercial construction lending practices, terms and conditions for construction loan advances;
- (v) the net proceeds of rent loss and/or business interruption insurance shall be paid to Agent, with any excess available after payment of principal, interest and any other amounts due under the Loan being delivered to Borrower; and
- (vi) any excess insurance proceeds remaining after restoration of the Project may be applied to the reduction of the Principal Balance of the Loan, in Agent's sole discretion.

Appendix A-2

Model insurance provisions for building loan⁸

1.1 Insurance. Borrower shall maintain insurance as follows:

(a) *Builder's Risk; Casualty; Business interruption*

- (i) During the Construction (and during any other period of repair or restoration of the Project), builder's risk 'all-risk' insurance written on a completed value form (100% non-reporting or its equivalent) insuring against loss customarily included thereunder including, without limitation, loss to materials in storage and in transit, loss or damage by fire or other casualty, with extended coverage for such other hazards (including, without limitation, collapse, debris removal, explosion, underground hazards, flood, earthquake, acts of terrorism, off premises power, demolition, increased cost of construction, including, without limitation, increased costs arising out of changes in applicable Laws and codes and all other coverage in so called 'all-risk' or 'Special Perils' form) with no exclusions for terrorist actions (except as expressly permitted in *Section 1.1(a)(vii)* below) or mold and also as Agent may require. Such insurance shall contain (w) a replacement cost endorsement equal to not less than 100% of the replacement cost value of the completed Improvements and 100% of the replacement cost of all tenant improvements and an agreed amount endorsement; (x) an endorsement covering so called 'soft costs' and 'extra expenses' including, but not limited to, loss suffered with respect to materials, equipment, machinery and supplies, whether on-site, in transit, or stored off-site, and with respect to temporary structures, hoists, sidewalks, retaining walls, and underground property, plans, specifications, blueprints and models in connection with any restoration following a casualty, soft costs and business income or loss of rents and extra expense including, but not limited to, plans, specifications, financial costs, blueprints and models in connection with any restoration

⁸ This is a sample only and is not to be construed as being endorsed or recommended by the author. Readers are advised to consult legal counsel to devise appropriate documents for their centres.

following a casualty (soft costs and business income or loss of rents and extra expense shall be written on an actual loss sustained basis with a period of indemnity for such length of time as would be required with the exercise of due diligence and dispatch to restore Borrower's business to the condition that would have existed had no loss occurred or as otherwise required by Agent); (y) an endorsement permitting occupancy of the Project; and (z) all insurance required to be carried by Borrower under the provisions of all Construction Documents. Flood, earthquake, demolition and increased cost of Construction, debris removal and off premises power failure coverages above may have sublimits and/or minimum limits as deemed acceptable to Agent. Such insurance policy shall name Borrower as the Insured. Such policy shall also name Agent under a non-contributing New York standard mortgagee clause or an equivalent endorsement satisfactory to Agent for real property and as 'Loss Payee' as respects total soft costs and business income or loss of rents. If the insurance required under this paragraph is not obtained by blanket insurance policies, the insurance policy shall be endorsed to also provide full building replacement cost to the Project and tenant improvements in an amount to be subject to the consent of Agent, which consent shall not be unreasonably withheld.

- (ii) From and after the Completion Date, property insurance against loss customarily included under so called 'all-risk' policies including, without limitation, flood, collapse, theft and earthquake, acts of terrorism, debris removal, off-premises power, comprehensive boiler and machinery, mold and such other insurable hazards as, under good insurance practices, from time to time are insured against for other property and buildings similar to the premises in nature, use, location, height and type of construction. Such insurance policy shall also insure the additional expense of demolition and increased cost of construction due to the enforcement of applicable Laws regulating reconstruction at the time of rebuilding following a loss, which insurance for demolition and increased cost of construction may contain a sublimit of \$/XXXX/. The amount of such 'all-risk' insurance shall be not less than 100% of the replacement cost value of the Improvements, without deduction for physical depreciation. Each such insurance policy shall contain an agreed amount (coinsurance waiver) and replacement cost value endorsement and shall cover, without limitation, all tenant improvements and betterments, which Borrower is required to insure in accordance with any Lease. Flood, earthquake, demolition and increased cost of Construction, debris removal and off premises power failure coverages in this *paragraph (ii)* may contain a sublimit acceptable to Agent. If the insurance required under this *paragraph (ii)* is not obtained by blanket insurance policies, the insurance policy shall be endorsed to provide also full building replacement cost to the Project and such tenant improvements in an amount to be subject to the consent of Agent, which consent shall not be unreasonably withheld. Borrower shall be named as the insured. Agent on behalf of the Banks shall be named as mortgagee or loss payee as respects real property and business

income or loss of rents under a New York standard Mortgagee Endorsement or its equivalent.

- (iii) At all times, if any portion of the Improvements is located within an area designated as 'flood prone' or a 'special flood hazard area' (as defined under the regulations adopted under the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973), flood insurance shall be provided, in an amount not less than the maximum limit of coverage available under the federal flood insurance plan with respect to the Project. Agent reserves the right to require flood insurance in excess of that available under the federal flood insurance plan. Should the available aggregate limits of flood insurance be eroded by losses so that the remaining limits available to pay losses are less than [XX]% of the required limits, Borrower shall promptly purchase additional coverage to restore the available limit and aggregate limit to not less than [XX]% of the required amount of flood insurance. Amounts of flood insurance required by this *paragraph (a)(iii)* shall be solely for the protection of the improvements. If the amounts of flood insurance required by any ground lease, condominium declaration, reciprocal easement agreement, covenants, conditions and restrictions, or the like are greater than the amounts required herein, then Borrower shall maintain such higher amounts of flood insurance. If the flood insurance and associated aggregate limits are shared among other locations, then the risks associated with other locations also insured in the same policy shall be taken into consideration in determining the amount of flood insurance to be provided herein.
- (iv) Prior to energization and at all times thereafter, comprehensive boiler and machinery coverage, with a \$[XXXX] minimum limit for all mechanical and electrical equipment with exclusions for testing removed. Such coverage shall include, without limitation, all tenant improvements and betterments which Borrower is required to insure and include, without limitation, coverage for soft costs, extra expense and rental interruption, as applicable, with at least a 365-day extended period of indemnity.
- (v) At all times Agent reserves the right to require rent loss and/or business interruption insurance on an actual loss sustained basis as an extension to coverage required by (ii); and (iii) above, in an amount not less than the amount of rent receivable or business income earned in an 18-month period and additionally providing a 365-day extended period of indemnity or as otherwise acceptable to Agent. Agent on behalf of the Banks shall be named as loss payee as respects this coverage using a New York Standard Mortgagee Endorsement or its equivalent.
- (vi) At all times during the term of the Loan, environmental liability insurance including mold coverage, against any and all claims, including all legal liability that could be imposed against Agent or the Banks to the extent insurable, and all court costs and attorneys' fees and expenses, arising out of or in connection with the presence of any Hazardous Materials at the Project, providing coverage in an amount not less than \$[XXXX] per incident or as otherwise acceptable to Agent,

naming Agent on behalf of the Banks as mortgagee under a New York standard Mortgagee Clause or its equivalent.

- (vii) The policies of insurance set forth in the foregoing *clauses (i), (ii), (iv), (v) and (vi)*, shall not exclude from coverage acts of terrorism and such policies, therefore, shall include 100% replacement cost insurance without co-insurance for damage to, or loss of rents from, the Project caused by terrorist activities (herein referred to as ‘*Terrorism Coverage*’). All policies of insurance set forth in this Section 1.1 shall have deductibles of not more than 5% of the insurable value of the Project. Should the available aggregate limits of terrorism coverage be eroded by losses so that the remaining limits available to pay losses are less than [XX]% of the required limits, Borrower shall purchase additional coverage to restore the available limit and aggregate limit to not less than [XX]% of the required amount of terrorism coverage. Amounts of terrorism coverage required by this *paragraph (a)(vii)* shall be solely for the protection of the improvements. If the amounts of terrorism coverage required by any ground lease, condominium declaration, reciprocal easement agreement, covenants, conditions and restrictions, or the like are greater than the amounts required herein, then Borrower shall maintain such higher amounts of terrorism coverage. If terrorism coverage and associated aggregate limits are shared among other locations, then the risks associated with other locations also insured in the same policy shall be taken into consideration in determining the amount of terrorism coverage to be provided herein.

(b) Liability

- (i) Commercial general liability insurance covering personal and advertising injury, bodily injury, death, accident, property damage and ‘x-cu’ hazards with a minimum limit of \$[XXXX] per occurrence and \$[XXXX] in the annual aggregate per location including products and completed operations liability coverage with at least \$[XXXX] in aggregate limits for a period of at least 5 years after completion of the Project; umbrella or excess liability insurance in excess of primary liability limits cited in *(i), (ii) and (iii)* below in combination no less than \$[XXXX] per occurrence and in the annual aggregate on per location basis. If aggregate limits are shared with other locations, the amount of umbrella or excess liability insurance to be provided shall be not less than \$[XXXX] in the annual aggregate. The policies described in this *paragraph (i)* shall cover, without limitation: elevators, escalators, independent contractors, contractual liability covering, to the maximum extent permitted by Laws, Borrower’s obligation to indemnify the Banks as required under this Agreement. The policies described in this *paragraph (i) and paragraph (ii)* below shall name Agent on behalf of the Banks as an additional insured on an endorsement acceptable to Agent. These policies shall contain cross-liability and severability of interest clauses, all reasonably satisfactory to Agent.
- (ii) Automobile liability covering Owned, Hired and Non-Owned Vehicle Liability shall be on an occurrence basis with a combined single limit of \$[XXXX] per accident.

- (iii) Worker's compensation insurance including employer's liability insurance for all employees of Borrower, if any, engaged on or with respect to the Project in such amount as is reasonably satisfactory to Agent, or, if such limits are established by Laws, in such amounts.
- (iv) Borrower shall ensure that the Construction Manager maintains similar liability coverage as is required from Borrower during Construction providing commercial general liability coverage, including, without limitation, products and completed operations with no less than \$[XXXX] in limits per occurrence and in the aggregate per project through primary and umbrella liability coverages or as otherwise acceptable to Agent. Such insurance shall name Borrower and the Banks as additional insureds. In the event that the Construction Manager and Borrower share coverages under the same policies, then no less than \$[XXXX] in limits per occurrence and in the aggregate per project through primary and umbrella liability coverages or as otherwise acceptable to Agent shall be required. Borrower shall also ensure that all Trade Contractors maintain similar coverage with limits of no less than \$[XXXX] per occurrence and in the annual aggregate per project or as otherwise as reasonably acceptable to Agent. All parties engaged in work on the Improvements shall maintain statutory workers' compensation and disability insurance in force for all workers on the job.
- (v) Notwithstanding the foregoing, Borrower may provide the commercial general and umbrella liability and workers compensation required in paragraphs (i) and (iii) above through the purchase of a wrap-up or owner controlled insurance program. This program shall have a limit of no less than \$[XXXX] per occurrence and in the annual aggregate dedicated to the Project only and shall also provide coverage for all parties engaged in construction operations at the Project site.
- (vi) Such other types, forms and amounts of insurance with respect to the Project and the operation thereof which are commonly maintained in the case of other property and buildings similar to the Project in nature, use, location, height and type of construction, as may from time to time be reasonably required by Agent.
- (vii) Borrower shall cause the Architect and each Engineer to obtain and maintain architect's or engineer's, as the case may be, professional liability insurance during the period commencing on the date of the Architect's agreement or such Engineer's agreement, respectively, and expiring no earlier than 5 years after occupancy of the Project. Such insurance shall be in an amount equal to at least \$[XXXX] per claim or such other limit as shall be approved by Agent.
- (viii) During the time of demolition (if any) of any Improvements, the Construction Manager and the demolition contractor shall separately maintain with respect to such demolition (A) commercial general liability coverage with limits of \$[XXXX] per occurrence and \$2,000,000 in the annual aggregate per location or project or as otherwise acceptable to Agent; (B) contractor's pollution legal liability covering asbestos and lead abatement, as well as removal or remediation

of underground storage tanks, with limits of liability of \$[XXXX] per occurrence or project or as otherwise acceptable to Agent; (C) automobile liability insurance covering owned, hired and non-owned vehicles with a combined single limit of \$[XXXX] per accident; (D) workers' compensation or employers' liability and disability insurance as required by Law; and (E) umbrella or excess liability coverages over the coverage required by *clauses (A), (C) and (D)* above with limits of no less than \$[XXXX] per occurrence and in the annual aggregate per location or project or as otherwise acceptable to Agent for the demolition contractor and no less than \$[XXXX] per occurrence and in the annual aggregate for the Construction Manager. The policies provided by such parties pursuant to this *paragraph (viii)* shall name Borrower and Agent on behalf of the Banks as an additional insured on all policies except workers' compensation or employers' liability and disability insurance on an endorsement acceptable to Agent on behalf of the Banks. Borrower shall maintain similar coverages as stated within this *paragraph (viii)* in *clauses (A), (C) and (D)*, if applicable; and (E) with limits of no less than \$[XXXX] per occurrence and in the annual aggregate per location or project or as otherwise acceptable to Agent on behalf of the Banks. The insurance required to be maintained pursuant to this *paragraph (viii)* shall provide not less than 30 days advance notice of change in coverage, cancellation or non-renewal or as otherwise acceptable to Agent on behalf of the Banks. Borrower shall also ensure that all Trade Contractors maintain similar coverage with limits of no less than \$[XXXX] per occurrence with respect to the coverage required by *clause (E)* above. The Trade Contractor coverages required by *clauses (A), (C), (D) and (E)* above shall also include the Construction Manager as an additional insured. Insurance required to be maintained above shall provide not less than 30 days advance notice of change in coverage, cancellation or non-renewal or as otherwise acceptable to Agent on behalf of the Banks.

(c) Form and quality

All insurance policies shall be endorsed in form and substance acceptable to Agent to name Agent on behalf of the Banks as an additional insured, loss payee or mortgagee thereunder, as its interest may appear, with loss payable to Agent on behalf of the Banks, without contribution, under a standard New York mortgagee clause. With respect to all insurance under *Section 1.1(a)*, no Person other than Agent on behalf of the Banks shall be named as loss payee. All premiums for such insurance policies and endorsements shall be paid for when the same are due and payable and all such policies and endorsements shall contain such provisions and expiration dates and be in such form and issued by such insurance companies licensed or authorized to do business in the State of New York, with a rating of 'A:X' or better as established by Best's Rating Guide (or an equivalent rating approved by Agent). If any insurance company issuing such insurance shall no longer have such required rating, Borrower shall, within 10 Business Days after notice from Agent, cause a replacement insurance policy(ies) to be issued by an insurance company licensed to do business in the State which has such required rating (upon

issuance of such replacement insurance policy(ies), Agent will simultaneously release the insurance policy(ies) being replaced). If any insurance company issuing such insurance shall enter into any form of regulatory or governmental receivership or other similar regulatory or governmental proceeding, or is otherwise declared insolvent or required to run off its insurance coverages, Borrower shall, within 5 Business Days, deliver to Agent a replacement insurance policy(ies) to be issued by an insurance company licensed to do business in the State which has such required rating. Each policy shall provide that such policy may not be cancelled or materially changed except upon 30 days' prior notice of intention of non-renewal, cancellation or material change to Agent and that no act or thing done by Borrower shall invalidate any policy as against Agent and the Banks. Borrower shall, promptly when available, deliver copies of all original policies certified to Agent by the insurance company or its authorized agent as being true copies, together with the endorsements required hereunder; provided, however, neither Agent nor any Bank shall be deemed by reason of the custody of such insurance policies to have knowledge of the contents thereof. The proceeds of insurance policies coming into the possession of Agent shall not be deemed trust funds, and Agent shall be entitled to apply such proceeds as herein provided. Borrower may effect such coverage under its blanket insurance policies, provided that (i) any such policy of blanket insurance either shall specify therein, or Borrower shall furnish Agent with a written statement from the insurer under such policy so specifying, (A) the maximum amount of the total insurance afforded by the blanket policy allocated to the Project; and (B) any sublimits in such blanket policy applicable to the Project, which amounts shall not be less than the amount required pursuant to this *Section 1.1*; (ii) any policy of blanket insurance hereunder shall comply in all respects with the other provisions of this *Section 1.1(c)*; and (iii) the protection afforded Borrower under any policy of blanket insurance hereunder shall be no less than that which would have been afforded under a separate policy or policies relating only to the Project. Borrower shall not take out separate insurance concurrent in form or contributing in the event of loss with that required to be maintained under this *Section 1.1* unless Agent is included thereon as a named insured with loss payable to Agent under a standard mortgage endorsement of the character and to the extent above described. Borrower shall promptly notify Agent whenever any such separate insurance is taken out and shall promptly deliver to Agent the policy or policies of such insurance. Each insurance policy shall contain a provision whereby the insurer: (1) waives any right to claim any premiums and commissions against Agent, provided that the policy need not waive the requirement that the premium be paid in order for a claim to be paid to the insured; and (2) provides that Agent is permitted to make payments to effect the continuation of such policy upon notice of cancellation due to non-payment of premiums. In the event any insurance policy (except for general public and other liability and workers compensation insurance) shall contain breach of warranty provisions, such policy shall provide that with respect to the interest of Agent, such insurance policy shall not be invalidated by and shall insure Agent regardless of (X) any act, failure to act or negligence of or violation of warranties, declarations or conditions contained in such policy by any named insured; (Y) the occupancy or use of

the premises for purposes more hazardous than permitted by the terms thereof; or (Z) any foreclosure or other action or proceeding taken by Agent pursuant to any provision of this Agreement or any of the other Loan Documents.

(d) Bank's right to procure insurance

Notwithstanding anything to the contrary contained herein, if at any time Agent is not in receipt of written evidence that all insurance required hereunder is maintained in full force and effect, Agent shall have the right (but not the obligation), upon notice to Borrower, to take such action as Agent deems necessary to protect its interests in the Project, including, without limitation, the obtaining of such insurance coverage as Agent deems appropriate, and all premiums paid and expenses incurred by Agent in connection with such action shall be paid by Borrower and shall be secured by the Building Loan Mortgage.

(e) Delivery of policies

Borrower shall promptly when available deliver to Agent certified copies (or other reasonable evidence) of the insurance policies required to be maintained pursuant to this *Section 1.1*, provided, however, neither Agent nor any Bank shall be deemed by reason of the custody of such insurance policies or copies thereof to have knowledge of the contents thereof. Borrower also shall deliver to Agent, within 10 days of Agent's request, a certificate of each insurance carrier, in form and substance satisfactory to Agent, evidencing the coverages set forth herein together with evidence that all insurance premiums due thereon have been paid and that such coverages are in full force and effect. Not later than 30 days prior to the expiration date of each of the insurance policies, Borrower shall deliver to Agent binders of all such renewal insurance policies. Such proof of renewal insurance shall include evidence satisfactory to Agent that all insurance premiums therefor have been paid and that the insurance coverages are in full force and effect. Any certificate of insurance delivered to Agent in compliance with the requirements of this Agreement shall include a letter from the relevant insurance company confirming that the entity issuing such certificate of insurance is authorized to do so, and in delivering such certificate such Person is acting as an agent of the insurance company providing the coverage. If such letter is not provided, then Agent will only accept insurance company issued binders confirming that the required insurance is in full force and effect.

1.2 Application of insurance proceeds

All insurance proceeds shall be paid to Agent and Agent shall apply insurance proceeds to costs of restoring the Project or to the Obligations as set forth in this *Section 1.2*.

(a)

In the event of any loss or damage to any portion of the Project due to a fire or other casualty (a '*Casualty Loss*'), Agent is hereby authorized either (i) to settle and adjust any claim under such insurance policies without the consent of Borrower; or (ii) to allow Borrower to agree with the insurance company

or companies on the amount to be paid upon the occurrence of a Casualty Loss; provided, however, that so long as no Event of Default has occurred Borrower may settle any Casualty Loss of \$[XXXX] or less without Agent's consent. In either case, Agent is authorized to collect and receive any Proceeds. Except as set forth in *Section 1.2(c)*, Proceeds may, at the option of Agent and subject to the terms of this *Article 1*, either be applied in payment or reduction of the Obligations, whether due or not, or be held by Agent and used to reimburse Borrower for the cost of the restoration of the Project. In the event that the Proceeds are not disbursed for restoration, Borrower shall nevertheless perform the restoration work, complete the restoration work at its sole cost and expense and shall not be entitled to Advances for any of such restoration costs.

(b)

Subject to the provisions of *Sections 1.2(a)* and *(c)*, Agent may elect to collect, retain and apply to the Obligations, whether due or not, all proceeds of insurance (individually and collectively referred to as '*Proceeds*') after deduction of all (including Agent's) expenses of collection and settlement, including attorneys' and adjusters' fees and charges, and so long as the Banks may have any obligations to advance further Loan proceeds, any remaining Proceeds shall be held by Agent. If Proceeds are applied in repayment of the Obligations, any unfunded Commitments and obligations of the Banks to fund further Advances shall be deemed automatically terminated. Any Proceeds remaining after repayment of the Obligations and termination of the Banks' obligations to make any further Advances shall be paid by Agent to Borrower or the Person entitled to receive them.

(c)

In the event of any Casualty Loss with respect to which the cost of restoration, as determined by the Banks' Inspecting Engineer, is less than \$[XXXX], Agent shall disburse Proceeds to Borrower to pay for the cost of restoration of the Project if (i) no Event of Default has occurred and no Default is then in existence, (ii) all Proceeds are deposited with Agent so that Agent may disburse such Proceeds in accordance with this *Article 1*, (iii) in Agent's judgment, the amount of Proceeds available for restoration of the Project (and any sums or other security acceptable to Agent deposited with Agent by Borrower for such purpose) is sufficient to pay the full and complete costs of such restoration, and the Loan is 'in balance'; (iv) in Agent's determination, the Loan-to-Value Ratio shall not exceed 75%; (v) in Agent's determination, the Project can be restored to an architecturally whole and economically viable project in compliance with all applicable Laws; and (vi) in Agent's determination, the restoration is likely to be completed and each of the Completion Conditions is likely to be satisfied not later than the Scheduled Completion Date. No disbursement of Proceeds made prior to the final completion of the Project shall exceed 90% of the value of the restoration work performed, from time to time. Any excess Proceeds which remain after the completion of restoration shall first be applied to the Obligations.

(d)

- (i) In the event that Proceeds are made available to Borrower for restoration, Borrower shall:
- (ii) subject to *Section 1.2(a)*, proceed with diligence to make settlement with the appropriate authorities and cause the Proceeds to be deposited with Agent;
- (iii) in the event of any delay in making settlement with the appropriate authorities or effecting collection of the Proceeds, deposit with Agent the full amount required to complete the restoration as aforesaid;
- (iv) in the event the Proceeds and the available proceeds of the Loan are insufficient to cause the Loan to be 'in balance,' promptly deposit with Agent or provide a Financial Covenant L/C in an amount necessary to cause the Loan to be 'in balance'; and
- (v) promptly proceed with the Construction, including the repair of all damage resulting from such casualty and restoration to its former condition.

(e)

Any request by Borrower for a disbursement by Agent of Proceeds and funds deposited by Borrower shall be treated by Agent as if such request were for an Advance, and the disbursement thereof shall be conditioned upon Borrower's compliance with and satisfaction of the same conditions precedent as would be applicable under this Agreement for an Advance.