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Are you managing your foreclosed property risk?

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The challenging economic conditions of the last few years has put many families out of their homes and forced businesses to close shop. Nearly 528,000 homes were taken over by lenders in the first six months of 2010, putting the total foreclosure rate on track to eclipse the more than 900,000 homes repossessed in 2009.

Unoccupied properties come with the potential for significant risk. For example, in one vacant, four-story, 12-unit condominium building, a sprinkler line froze during cold temperatures and burst, causing approximately $300,000 in damage to eight of the condos. Another case involved an unoccupied single family home, destroyed in a fire from a malfunction in the wiring of the stove, and resulted in a $226,000 claim for total loss.

With foreclosures on the rise, vacant structures are becoming a growing part of financial institutions' portfolios. Managers of these portfolios need to consider how to protect such properties, as well as to plan for the possibility that there may be more to come. The lack of day-to-day activity within unoccupied properties makes them a prime target for maintenance and crime-related losses that need to be reflected on, such as:

- **Fire damage.** According to the National Fire Protection Association (NFPA), from 2003 to 2006, U.S. fire departments responded to an estimated average of 31,000 structure fires in vacant buildings. Many of these incidents were the result of inadequately maintained fire protection systems; others were the result of arson, as vacant buildings are often a popular target of this crime.
- **Freeze losses:** The risks associated with freezing temperatures are magnified in a vacant property. Without the regular operation of heating systems or proper pipe drainage, pipes may easily freeze and ultimately burst, causing significant water damage to a structure.
- **Criminal concerns.** An empty structure can sometimes invite criminal activity. One such risk is theft of building components, such as copper piping and wire, for sale on the scrap metal market. Vandalism can also be a concern.
- **"Everyday" risks.** In an occupied property, routine, small hazards can be quickly identified and repaired. But when a property remains empty for an extended period of time, these problems may be undetected and therefore unlikely to be corrected in a timely manner. Thus, a small, unnoticed water leak could potentially escalate into a more frustrating and, ultimately, expensive concern.

Mitigating the risks
Though different classes of property have different risks, there are some general guidelines enabling financial institutions to properly manage the exposures linked to ownership of idle properties. The following are some best practices for how to best mitigate these risks.

- **Make someone accountable.** A key element to successfully controlling the exposures that foreclosed properties impose on a financial institution is to designate an individual to accept responsibility and be proactively accountable for monitoring/maintenance.
- **Check in with your insurance providers.** Keeping your institution's insurer and/or agent or broker informed is essential. Your insurance advisor can review the existing

property policy and recommend the proper coverage, and also help identify the specific hazards and provide additional risk management suggestions.

- **Regularly inspect the property.** Conducting a regular walk-through of any vacant properties is essential, on a weekly basis for lower value, lower hazard facilities, and, every one or two days, for higher value, higher hazard facilities.
- **Keep fire prevention in mind.** When a property comes under the control of a financial institution, the local fire department should be notified immediately so they can be aware that it is unoccupied. All flammable liquids and combustible materials should be removed from the building and automatic sprinkler systems should be maintained.
- **Secure the site.** In addition to the fire department, the local police department should be notified. Alarm systems should remain active. Locksets and deadbolts should be changed as soon as possession is taken.
- **Keep detailed records.** Individual files should be created for each foreclosed property, documenting initial property condition, inspections and all maintenance performed. Be sure to regularly update these records and indicate any changes that occur to the property.
- **Commit to ongoing maintenance.** Avoid the headaches associated with the escalation of day-to-day maintenance issues by identifying qualified contractors in advance and hiring them to provide ongoing building-maintenance functions.

Interestingly, vacant properties can sometimes expose owners to more hazards than those that are occupied. And financial institutions need to take notice, as the number of these properties in their portfolios is growing. Nearly 528,000 homes were taken over by lenders in the first six months of 2010, putting the total foreclosure rate on track to eclipse the more than 900,000 homes repossessed in 2009.

With the continued economic downturn, financial institutions need to consider how to manage vacant properties already in their portfolios, as well as plan for the possibility that there may be more to come. Though the risks can often be intimidating and quite costly, vacant property owners can take advantage of some easy-to-implement safeguards—regular inspections, continued maintenance, police and fire department notifications, etc.—and minimize the chance of experiencing and expensive loss.

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North Western Financial Review – November 2010
Banking on Insurance – Insurance News for the Banking Industry – Fall 2010
Texas Banking – November 2010
Mass Bankers e-News – April 13, 2011