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eNews Headline: When is Flood Insurance Required on Building Contents?

Question: We have a clause in the boilerplate in our deeds of trust for commercial property that the contents of the building also secure our loan. Now we have an examiner telling us that flood insurance would be required on those contents. Is that correct? How much flood insurance would we require if we do not know the value of the contents?

Answer: Although there is no separate security agreement for personal property, clauses like that can be problematic under the Flood Disaster Protection Act.

In the 2011 FAQ's, #39 makes it clear that if both the building and the contents secure the loan, flood insurance is required on both the building and the contents.

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Q: Is flood insurance required if a building and its contents both secure a loan, and the building is located in an SFHA in which flood insurance is available?

A: Yes. Flood insurance is required for the building located in the SFHA and any contents stored in that building.

Example: Lender A makes a loan for \$200,000 that is secured by a warehouse with an insurable value of \$150,000 and inventory in the warehouse worth \$100,000. The Act and Regulation require that flood insurance coverage be obtained for the lesser of the outstanding principal balance of the loan or the maximum amount of flood insurance that is available under the NFIP. The maximum amount of insurance that is available for both building and contents is \$500,000 for each category. In this situation, federal flood insurance requirements could be satisfied by placing \$150,000 worth of flood insurance coverage on the warehouse, thus insuring it to its insurable value, and \$50,000 worth of contents flood insurance coverage on the inventory, thus providing total coverage in the amount of the outstanding principal balance of the loan. Note that this holds true even though the inventory is worth \$200,000.

Paraphrasing that particular FAQ, contents insurance is required when:

1. Contents are taken as collateral; and
2. The bank also takes the building where the contents are located as collateral; and
3. The building is located in a special flood hazard area.

Each condition must be met for flood insurance to be required.

As for the second question, how is insurance allocated between the building and the contents, the agencies have said that the bank and the borrower may allocate the amount of insurance between the building and contents in any 'reasonable' way provided both the building and the contents have some amount of coverage.

Below is from the preamble to those same FAQs.

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The Agencies agree that the practice for flood insurance coverage for multiple buildings would also be applicable to coverage for both contents and building. That is, both contents and building will be considered to have a sufficient amount of flood insurance coverage for regulatory purposes as long as some reasonable amount of insurance is allocated to each category. The Agencies have added an example to this question and answer to illustrate this point. The Agencies otherwise adopt the question and answer as proposed.

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