

COMMERCIAL PROPERTY

LENDERS CRACK DOWN ON INSURANCE REQUIREMENTS

LENDERS ARE tightening commercial insurance requirements for borrowers to ensure that they are adequately covered as property, liability and business interruption claims costs rise across the board.

That means commercial property buyers should start their insurance planning well before loan closing or refinancing discussions. Lenders want to know that the property is protected, not only for the sake of your investment but also to safeguard the money they are putting into the loan.

Besides demanding adequate coverage limits, lenders are strictly enforcing A-rated insurer requirements and requiring updated appraisals to ensure one claim doesn't wipe out a borrower's ability to repay the loan.

Essential insurance for loans

When seeking a business loan, lenders may require borrowers to prove they have several types of insurance. Here's how lenders are scrutinizing three of the most commonly required policies:

Property — Lenders are concerned that property values may be understated in light of rampant rebuilding cost inflation. If a major loss occurs, inadequate coverage could create a funding gap that the policyholder would have to cover out of pocket.

Business interruption — Lenders prioritize business interruption coverage because it directly impacts a borrower's ability to make loan payments if disaster strikes. If a business is unable to operate due to a fire or supply chain disruption, it could severely affect its cash flow.

Business interruption may be included in the language of a commercial property policy, but it's important to ensure it is also suitable for lending purposes.

General liability — Lenders also want their borrowers to have a general liability policy in place that has adequate policy limits. They may require that the borrower carries additional umbrella insurance to cover the cost of large claims.

Liability insurance rates have been rising rapidly due to an explosion in large settlements, often in the tens of millions of dollars. Lenders are insisting that businesses taking out loans have policy limits that will ensure they can stay viable after a large verdict.

Other considerations

As claims costs have risen, lenders are increasingly reviewing endorsements, limits and policy language more carefully to ensure compliance with loan agreements and confirm that insurance can cover most eventualities.

Lenders often request particular wording and endorsements that ensure their rights are protected. These may be found in certificates of insurance or within the policy, including:

Mortgagee clause and lender loss payable wording — This clause ensures the lender is paid if a covered loss occurs. It prioritizes the lender's interest in the event of a claim.

Proof of insurance showing correct limits and dates — The lender may request a certificate of insurance that lists policy limits, effective dates and contact information for the insurer. Any mistake can delay closing.

Replacement cost valuation — Lenders want the property insured at full replacement cost. This means the policy should reflect what it would take to rebuild the structure today, not what was originally paid for it.

Acceptable deductible levels — Some lenders limit how high the deductible can be. If the deductible is too high, they may require changes before approving the loan.

Some issues can delay closings on properties or cause problems after the loan is made, such as:

- Missing additional insured endorsements,
- Insufficient umbrella limits, or
- Inconsistent named insured listings.

Finally, if you are applying for a loan, reach out to us early as the market has changed drastically, particularly in high-risk areas.

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