By Charlotte Allen

Insurance Basics

When sitting down to write an article on the subject of insurance basics my first reaction was "there is nothing basic about insurance." This is because there truly is no cookie cutter property, no such thing as "apples to apples" coverage and rarely multiple claims occurring and handled in the same exact way. Many circumstances, property attributes and policy features dictate how insurance works and what each client experiences. However insurance is specifically based on and around the notion of the unforeseen. And although the future cannot necessarily be assumed, we must protect our investments against, at the very least, the most predictable losses. This means looking to experts in the industry, such as insurance brokers, attorneys, reserve analysts, etc. These professionals can collaboratively determine what types of losses your particular investment faces and how to protect yourself during and after a potential loss.

Insuring your association accurately should be based on a few key elements, meeting both Davis-Stirling requirements and CC&R guidelines, more recently lender requirements, specifically Fannie Mae and Freddie Mac guidelines, as well as considering your particular property characteristics, how the association functions and who and/or what needs to be protected. Some common and frequently addressed insurance coverage communities tend to insure for, and in most cases must insure for, are Property Coverage for hazards such as fire and windstorm, General Liability, Directors and Officers Liability, Crime and Workers Compensation.

Property Value/Replacement Cost

Insuring the property accurately can prevent the potential for hefty out of pocket expense to unit owners at the time of a major property loss. Building value calculations can be provided through replacement cost estimating systems such as Marshall Swift Boeckh (www.marshallswift.com), a well known industry wide program. Property information used to rate should be based on research and accurate square footage your broker has obtained.

Fannie Mae's Selling Guide B7-3-03 requires that a homeowners association be protected by the full insurable replacement cost of the entire project. There are a few ways to meet this standard. A policy can contain either a Guaranteed Replacement Cost endorsement, offer no co-insurance (or coinsurance waived), or have an Agreed Value clause. If the association's policy contains none of these things, the value or limit of coverage simply has to be an accurate replacement cost for the entire project. Insurance agents can provide proof of this by offering lenders the completed valuation cost estimate.

Building Ordinance Coverage A, B and C

Building Ordinance Coverage A (Contingent Liability) provides coverage for undamaged portions of property. For example, if half of a building burns down, the Property Insurance Coverage will replace the half of the building that is damaged. However, a majority of the cities and counties in California, for example, have ordinances that would require the Association to demolish the remaining 50% or less and rebuild as a whole. Since the unburned portion of the building is undamaged, the Property insurance section does not provide coverage unless Building Ordinance Coverage A is included.

Coverage B (Demolition) provides coverage for demolition. This coverage is self-explanatory; however, demolition can become costly if heavy machinery is needed.

Coverage C (Increased Cost of Construction) provides coverage for building code upgrades (local ordinances) and/or increased cost of construction. For example, assume that a building was to burn down and local ordinance requires that the reconstructed building include updated fire sprinklers and hard wired fire alarm system. Building Ordinance C will provide this coverage to the Association.

Deductibles

An insurance deductible is the amount the insured must pay of a covered loss. Deductibles represent a sharing of the risk between the insurance company and the insured. Deductibles are often specific dollar limits but can also be a percentage of the total limit of insurance or total replacement cost of the property. Typically the deductible can affect the premium charged for a policy; The higher the deductible, the less premium charged.

Commercial General Liability

Commercial General Liability is typically a very broad policy and includes coverage for loss exposure such as property damage, bodily injury and personal injury. The Davis Stirling Act requires at least two million dollars ($2,000,000) in Commercial General Liability limits if the common interest development consists of 100 or fewer separate interests and at least three million dollars ($3,000,000) if the common interest development consists of more than 100 separate interests.

Umbrella Liability

Umbrella Liability policies are meant to extend coverage beyond its underlying limits. A broad Umbrella policy will offer coverage for General Liability, Directors and Officers coverage as well as any Workers Compensation the association may maintain.

Directors and Officers Liability

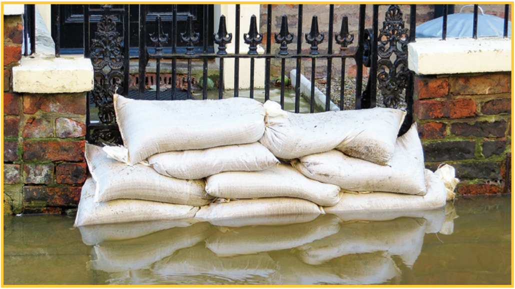
Board members are charged with making day to day decisions in the best interest of the community. Directors and Officers Liability (D&O) insurance protects volunteer Board of Directors and potentially their personal assets while making decisions on behalf of the association. It is imperative that board members are protected. Davis Stirling Act (Civil Code§5800) requires Associations to carry a minimum limit of $500,000 for D&O and $1,000,000 for associations consisting of 101 or more units. A broad stand alone D & O policy should include coverage for Duty to Defend (which offers coverage for defense even if the loss itself isn't covered), defense outside the limits (in order to avoid defense costs exhausting the total limit of insurance), coverage for non-monetary claims, and should additionally insure Management.

Employee Dishonesty/Crime

Employee Dishonesty or Crime coverage is often required by CC&Rs and is essential should association funds be stolen. Although typically difficult to do so, there is still a possibility for theft and therefore the policy your association purchases should offer coverage in the event one or both of the aforementioned parties gets away with association funds. Make certain your policy includes coverage for non compensated employees (Board Members) as well as Management. You can rely on CC&Rs to determine the limit of Fidelity Bond coverage your association needs to maintain but understand lenders have their own requirements that may not correlate to what your CC&Rs say. Fannie Mae now reviews crime coverage and requires the limit of insurance be equal to the maximum limit of association funds at any given time.

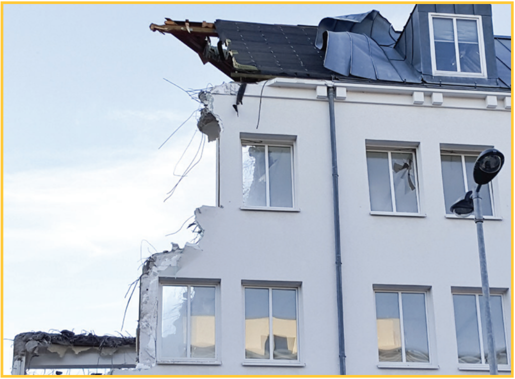
Workers Compensation

Workers Compensation is a "no fault" insurance structure which provides benefits for injured workers. Common Interest Developments should carry Workers Compensation whether they have employees or not. A community which lacks employees and wages nothing in payroll may question the necessity for this type of policy. However there are multiple causes an injured person can qualify as an employee of the association. Instances such as uninsured vendors, insured vendors with a lapse in insurance coverage, and privately hired vendors injured in the association's common area are all past examples of common interest developments being deemed employers at the time of injury.



Flood and Earthquake Insurance

Not all properties are required to carry flood or earthquake insurance but any property can. Over the span of a 30 year mortgage a home is 16% more likely to experience flood than fire. Associations located in mandatory flood zones (A or V) must maintain flood insurance coverage. This is a given however Fannie Mae now requires that the flood coverage limit be either full insurable replacement cost value or the NFIP maximum (which for condominiums is $250,000 per unit). If the association's flood insurance is insufficient the lender can and will force place supplemental coverage at the owners' expense. Fannie Mae guidelines also require that flood deductibles not exceed $25,000 per building.



Earthquakes can happen anywhere without warning. Even the smallest of earthquakes can cause significant damage to a structure. If an Association is contemplating the purchase of an insurance policy covering loss such as earthquake or flood or if community members have approached the board and want the idea explored further, there are a few steps the Association can take.

1) Contact a broker who specializes in common interest communities and request insurance options for this type of coverage.
2) Offer facts to the community such as what coverage your association has available, how much it will cost, what the cost might mean for assessments, how deductibles work, etc. Your broker should be able to help you gather the data necessary.
3) Determine if this coverage and cost warrants a membership vote.

Insurance isn't necessarily basic but if you understand the aforementioned, and commonly discussed types of policies, and that adding and excluding various coverage options is what differentiates one policy to the next, you will be able to make important coverage decisions before a loss occurs. Make certain you understand what exclusions each policy has. Confirm your policies meet Davis Stirling requirements and coincide with your association's CC&Rs. Be confident all property exposures are disclosed to the insurance company and know exactly what monetary commitment you have at the time of loss.

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As seen in the *2016 Condominium Greenbook*, Formerly known as the Community Association Treasurer's Handbook. A Comprehensive Guide to Accounting, Financial Matters and Income Taxes for California Homeowners Associations.

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