INSURING YOUR COMMUNITY ASSOCIATION

A White Paper

PROFESSIONAL INSURORS AGENCY, LLC

WRITTEN BY
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Insuring your Community Association A

Whitepaper by:

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YOUR BUSINESS
DESERVES MORE
THAN AN AGENT,
TRUST A
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Risk Management

Since Insurance is an instrument of Risk Management we need to see the larger picture for a minute. Managing your risk or Risk Management is something practiced by the largest companies in the world down to the personal level. Risk Management is broken down into 4 basic techniques:

Avoidance – One way to prevent risk is to avoid it all together. For instance, instead of building a pool and then deciding how to manage the risk of the pool, you could never build it in the first place. You would be avoiding the pool risk.

Retain – Another method is to retain the risk. An example of that would be to not insure smaller items at all. When we have a property insurance claim, we also retain part of the loss. That is called a deductible and many of us work with those frequently.

Mitigate – When we mitigate the claim we work to reduce it. Some examples of this are security cameras, signs, and lifesaving equipment.

Transfer – There are two popular methods for transferring risk:

> *Insurance* – When we insure something, we are transferring the risk to an insurance company. The insurance company collects a premium to assume this risk. This is the main focus of this paper.
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> *Contractual Risk Transfer* – often referred to as CRT, this is a method used by many to transfer risk to other through contracts. Some examples of this are construction or service contracts where the contractor assumes all or a portion of the risk for the work they are doing. Another is a lease contract. There are many other examples but we will focus on these within this paper. We will address CRT at the end of the paper more completely.

General Insurance Provisions

One of the most important general provisions of insurance is the Named Insured on the policy. I have seen many mistakes on this throughout the years. It is very important to get the name on the policy correct. Never rely on the current or old policy to make sure this is correct. Go to the source documents of when the company (association) was formed. Another way to check on this is to look up the Secretary of State's web site or other governing body in your state that works with the formation of legal companies. In a Community Association, there are sometimes multiple sections and names, and therefore they should all be named on the policy as a "named insured". Keep in mind that the first company named in the policy is considered the primary customer and will be the one that receives any notices, endorsements, return or additional premiums, or has the right to cancel the policy. The name on the policy should be exactly as it appears with the state and on legal documents.

Another important provision of both Property and Commercial General Liability policies is the locations listed. Make sure to list the address if possible. If not possible make sure to list a larger area such as the corner of Main and 1st street if that is where the neighborhood is located. Make sure your general liability does not contain a *premises limitation endorsement*. This limits coverage to just exactly the address(s) in the policy.

Finally make sure your effective dates overlap. You want your new policy to take effect on the same date your old one expires. This is because they expire at 12:01 am of the date listed on the policy. For example, if your policy expires on 1/1/2013, your new policy should be from 1/1/2013 to 1/1/2014. Some insured's mistake that they can skip to 1/2/2014.

Property Insurance

Causes of Loss

One important part of Property Insurance is the covered causes of loss. The two major categories of this are "named perils" or "special form".

Named perils lists within the policy exactly what perils the policy covers (ex. Fire, theft, burglary, water damage, hail, wind, weight of snow or ice, lightening, etc.) If the perils are not listed, they are not covered.

Special form instead covers all perils that are not specifically excluded. Some common exclusions on special form are flood and earthquake. It is obviously better to have "special form" if the insurance carrier will allow this.

Pay particular attention if you are insuring outdoor property such as fences or playground equipment to make sure the perils that are covered are what you want. I have seen many times that fence coverage excludes wind damage, which is the most common peril to destroy fencing.

Valuation

The most common types of valuation are Actual Cash Value and Replacement Cost. There are advantages to both however Replacement Cost is considered the better coverage if it is available.

- **Actual Cash Value (ACV)** – This is where you insure the property for its actual cash value. The insurance company defines this as its replacement cost minus depreciation. Since you cannot always find a value on used or older property easily, there is a method in which they determine the depreciation that might not exactly be its value if you sold it to someone. A common example of this would be someone having a total loss on their 5 year old vehicle. The insurance company is not going to buy you a brand new vehicle but pay you what the vehicle is worth. However, vehicles are much easier to determine values on than say a 10 year old shingle roof, so the insurance industry has methods to determine the depreciation. The one advantage of carrying "actual cash value" insurance is you can carry less insurance on the item and usually reduce your cost. I would consider this the only advantage however and would usually opt for "replacement cost coverage".

- **Replacement Cost (RC)** – With replacement cost the insurance carrier will reimburse you for the cost to replace the damaged property with like kind and quality. The way this is usually done is that they will initially pay you the ACV (see above) until you actually replace the property. At that time, you show proof you have replaced the property and they will reimburse you for the difference. An example would be a 10 year old roof was damaged and the insurance carrier determined the ACV was $6,000 and the replacement cost was $10,000. They would pay the $6,000 until you had replaced the roof and then pay you the additional $4,000. The thing to remember is to insure the property to its replacement cost in order to have adequate coverage. If you insure it for less than its replacement cost with this provision you could have co-insurance penalties or just not enough insurance to fix or replace the property.

Coinsurance

The word "coinsurance" may be the most misunderstood and confusing term in the world of insurance.

One definition of "coinsurance" is used interchangeably with the word "co-pay" - the amount the insurance company pays in a claim. An eighty- percent co-pay (or coinsurance) clause in health insurance means the insurance company pays 80% of the bill. A $1,000 doctor's bill would be paid at 80% or $800. So basically forget what you know about health insurance when evaluating coinsurance in your property policy.

The term "coinsurance" when used in the context of property insurance has an altogether different meaning. Here, coinsurance is the percentage of value that the policyholder is required to insure. A building with a value of $1,000,000 and a policy with an 80% coinsurance clause must be insured for at least $800,000.

To make life more complicated, "value" is determined at the time of the loss. If the amount of insurance is found to be under the coinsurance percentage then a penalty is applied reducing the claim payment. This hurts the policyholder.

Using our building and policy mentioned above as an example illustrates the point. If the policyholder decides to buy $600,000 of insurance and a $200,000 fire occurs, the claim is calculated by dividing what was purchased ($600,000) by what should have been bought ($800,000). The result in this case is 75%. The factor is multiplied by the amount of the loss. The calculation works out:

$200,000 X .75 = $150,000.

The policyholder will receive $150,000 (less any deductible) for the $200,000 claim.

Almost all property insurance policies contain a coinsurance clause. Building insurance, contents coverage, computer coverage, inland marine policies, tool and equipment floaters all contain the penalty clause mentioned above. Some require 100% of the value!

In property insurance, coinsurance will never result in a larger payment on a claim. It can only reduce the settlement or have no impact. In "better" times insurance companies offered to eliminate the coinsurance clause for almost no premium. Most insurers now charge for the removal of the penalty. In many instances such is worth the extra premium.

Remember, coinsurance in property insurance never helps the insurance buyer. Eliminate it when possible. When you can't, the lower percentage coinsurance is the best. Eight percent (80%) is always better than 100%.

Types of Property to Insure

Building(s) – Building coverage for Condominium Associations differs greatly from HOA's or Office Park Associations. Since the coverage differs so much we will discuss them separately here. Office Parks can have the building owned by the Association or Individuals in the park, so you will need to know how this is to apply them appropriately.

Condominium Owners Associations – Condominium Owners Associations most always have ownership in the buildings to some extent so they are responsible for insuring the portion that they have ownership in. This is determined by the by-laws so it's important for both the Association leadership and the individual buyers to read and understand their responsibilities for these. Some of the most common types of arrangements are:

> Bare walls-in- Covers all real property from the exterior framing inward, but does not cover the fixtures and installations within the condo unit. So, things like granite countertops, bathroom and kitchen fixtures, and the flooring are not covered by the master policy. This condo owner will probably have the greatest coverage need.
>
> All-in - Covers fixtures, installations or additions within the interior surfaces of the perimeter walls, floors and ceilings of individual units. This condo owner will probably have a more limited coverage need.

Homeowners Associations or Neighborhood Groups – these groups typically solely own the property and it is in the name of the group or association. They should insure the entire value of the property if they elect to insure the item(s).

Business Personal Property (Contents) – This consists of items located within a building or outdoors in some instances. Outdoor property can be limited in both coverage amounts and perils so be sure to double check this. Examples may be furniture, computers, phones, or other similar items that are not attached to the building.

Inland Marine – this is a funny name for a special kind of insurance. Since some equipment like lawnmowers and other landscaping equipment may be moved from place to place you can't list a location where it is located on the normal Property policy. The way to cover this is with an Inland Marine floater. It will protect the property wherever it is moved to and usually be specifically scheduled like a vehicle is on an auto policy. This policy will have its own deductible and the items will usually be covered for Actual Cash Value (ACV) as was previously discussed.

Fences – Some insurance carriers will cover fences specifically but only for named perils. Others will cover for special form which will cover all major perils that the fences can be subject to. The main claims on fences are obviously wind damage and this peril is usually excluded unless special form is specified in your policy.

Signs – This is another area that is subject to the same rules above as the fences.

Pools – I advise pool equipment be specifically listed in the policy to avoid any confusion during claims. The actual pool can be covered by some carriers. Others will cover the pool but exclude underground property. This is obviously not the type of coverage you should purchase, so look carefully that they have specifically removed the pool from the definition of underground property.

Builders Risk – if you are building a new building you may elect to purchase a builders risk policy instead of covering it under building coverage. There are advantages in doing this such as property off premises coverage, property in transit coverage, and property to be installed coverage. This is best to discuss with your agent prior to starting construction.

Deductibles

Standard deductible – for years this was the way that all deductibles worked except in coastal areas. You had one deductible per occurrence that applied to all property coverages on your policy. A hail storm that hit the property would be considered one occurrence so you would have only one deductible. This is still common practice for smaller properties.

Percentage Deductible – This is a new development in property insurance. I have seen deductibles range from 1% to 5% for wind and hail only. All other perils (AOP) are still adjusted using your standard deductible. Keep in mind with this that the percentage is a percentage of the value of the property. For example if you have a $1,000,000 building and it has a roof loss of $100,000 from hail, the deductible if you had a 1% deductible would be $10,000 or 1% of the value of the building value.

Split Deductible – Some policies, especially on Condominium Associations, contain split deductibles. You will have a standard deductible for all perils other than wind and hail, and a percentage deductible or higher deductible on the perils of wind and hail with a minimum.

Commercial General Liability Insurance

General Liability insurance is for insuring against *Bodily Injury* or *Property Damage* claims caused by your negligence. This coverage is essential if you own property, land, pools, or lakes. The premium is based upon your exposures so the more land, units or houses, ponds, pools, playgrounds, or sports courts, the higher your premium will be.

Limits

There are several limits and sub limits that most every general liability policy contains. Hopefully this helps you understand the different limits on your policy:

General Aggregate - The maximum amount the Insurer will pay for all claims (below)during the policy period. The most common limit for this is $2,000,000

Products/Completed Operations - Products coverage protects against the liability for injury, loss, or damage that an Insured may incur as the result of some defect in the product sold or manufactured. Completed Operations covers liability claims arising out of work competed away from the business premises, occurring after operations have been completed, or after an item is installed or built. The most common limit for this is $1,000,000

Personal/Advertising Injury - Personal injury means injury other than bodily injury, resulting from false arrest, false imprisonment, malicious prosecution, wrongful eviction, wrongful entry, the invasion of privacy of a premise, libel, or slander. Advertising injury covers damages or injury sustained by a claimant in the course of the advertising activities of the Insured, such as libel, slander, or the infringement of copyright. The most common limit for this is $1,000,000

Each Occurrence - The maximum amount payable for a single event or accident, regardless of the number of claims or claimants. An occurrence is also defined as a continuous or repeated exposure to the same harmful conditions. The most common limit for this is $1,000,000

Fire Damage Limit - Coverage for fire damage caused by negligence on the part of the Insured, to premises rented to the Named Insured. (If a fire occurs because of negligence of the Insured and causes damage to property not rented to the Insured, coverage would be provided under the occurrence limit.) The most common limit for this is $50,000

Medical Expense Limit - Medical expenses resulting from bodily injury to a third party caused by an accident on premises owned or rented by the Insured, or locations next to such property, or when caused by the Insured's operations. These payments are made without regard to the liability of the Insured. The most common limit for this is $5,000 per person. Payment being made under medical payments does not reduce the occurrence limit but does reduce your general aggregate.

General Liability excludes exposures related to decisions of the board of directors. This coverage is available under Directors & Officers Liability. One of the worst endorsements you can have on your General Liability is a Designation of Premises endorsement. This limits coverage to only specified locations on the policy. If this endorsement is attached and there are no alternatives, it is important to make sure all locations are listed. I also like to use a broad location definition such as the intersections of the neighborhood or a legal address.

Crime Insurance

Crime Insurance is mostly used for Community Associations to insure against theft of the funds or property from the association by its board, officers, employees, & property manager.

If you manage your own funds you may wish to purchase crime coverage. An annual income is sometimes recommended for a limit but keep in mind that these type of claims can sometimes go on for years without being discovered, so that might not be enough coverage. It is best, even if you have this coverage to split up the duties of the treasurer among several officers. For example a best practice is to have one person pay the bills, another to deposit checks and yet another to reconcile the account. Another practice is to have 2 signature checks if your bank will allow this. Some insurance carriers require this level of internal controls before they will consider this coverage.

Additionally, many property management firms carry this type of insurance. Some carriers will allow you to buy this coverage and will cover the property management firm for their management of the funds. The advantage of you insuring your own funds is that you will be the one named on the check as a primary beneficiary. If the property management firm carries the coverage, their insurance carrier will usually just pay them for the loss and you will be required to obtain your funds from them.

Commercial Automobile Insurance

Since most Community associations do not own automobiles I won't go into great detail on automobile insurance for CA's. One coverage that I usually recommend however is Hired and Non-Owned Automobile.

Non-Owned Auto Liability - Coverage is provided only for autos not owned, leased, hired, or borrowed by the named insured. Coverage includes autos owned by the insured's employees, officers, volunteers, or members of their households, but only while used in the named insured's business affairs. No physical damage coverage applies.

Hired Autos - Coverage is provided only for autos leased, hired, rented or borrowed for use in the named insured's business. Physical damage is not covered here as that is an additional available coverage.

Directors & Officers Liability

Directors & Officers Liability or D&O Liability is liability insurance payable to the directors and officers of a company, or to the organization(s) itself, as indemnifications for certain damages (losses) or advancement of defense costs in the event any such insured suffers such a loss as a result of a legal action (whether criminal, civil, or administrative) brought for alleged wrongful acts in their capacity as directors and officers (as to the individual directors/officers) or against the organization for actions against the organizations themselves). As coverage is different among carriers some important clauses to look for are:

Defense Limits outside of limits – As defense of claims can easily exceed the cost of any awards, it's important to know if your policy had defense within the stated limit on the policy or outside your limits and therefore, unlimited. If available, you always want the defense outside of your limits to increase your coverage available for court awards.

Breach of Contract Coverage – this gives you coverage for your failure to comply with contracts that are in place between the Community Association and third parties.

Non-Monetary Damages – Many policies do not cover claims unless there are monetary damages. As there can be lawsuits without monetary damages such as a resident suing for a dispute with the architectural committee or board about the approval of building plans. As there may be no money damages sought it's important to have this coverage included when possible.

Management Company Additional Insured – many management companies require you add them as additional insured on your policy or to indemnify them and hold them harmless in the event you cause a claim or lawsuit to be filed on them. Some D&O policies automatically cover the management company. When possible this is a best practice.

Employment Practices Liability – this coverage is normally not an issue unless you have employees. If you do have employees, having this included in your D&O can save you money by having your coverage all on one policy. This coverage protects you from employment related claims such as harassment, discrimination, and related claims.

Lifetime Reporting for former Directors & Officers – if the board in the future decides not to purchase D&O liability coverage for past directors provided under the policy remains for the lifetime of the individual.

Libel, Slander, Defamation coverage – this is covered under some D&O policies.

Umbrella Liability Coverage

Umbrella liability is often a misunderstood coverage. Many people seem to think that an umbrella is liability that covers them on a primary basis for all types of liability claims. While this is in theory somewhat possible, it would be misleading to say that. What the umbrella does is give you higher limits on at least 1 underlying coverage. The most common type of coverage that the umbrella extends is the General Liability coverage. An umbrella sits on top of 1 or more underlying policies to provide coverage in case one of the underlying policies goes beyond its limit of coverage. So if you purchased $1,000,000 in General Liability per occurrence and you purchased a $5,000,000 umbrella liability policy you would have $6,000,000 available for any 1 claim. Umbrellas are often quite affordable and recommended for anyone with hazardous exposures such as playgrounds, ponds, or pools.

Other type of coverages that umbrellas can extend limits on in some cases:

- D&O – some policies actually extend the limits for your D&O policy. This is a great way to give yourself higher limits for little money.
- Commercial Auto including hired/non-owned auto liability coverage.
- Employers Liability under Workers Compensation

*An important issue with Umbrella policies is that they actually list the underlying policies within their declaration pages. If you have underlying policies with non-concurrent dates (not all expiration dates are the same), it's important to have the policy endorsed when each non-concurrent policy renews to keep the umbrella up to date.

Workers Compensation Exposures

Do I need Workers Compensation? That is a very complicated question. Here are best practices based on your situation:

If you hire a management company that then hires the contractors:

- Have a contract with them that includes an indemnity clause in your behalf
- Have them provide you with a certificate of insurance for General Liability, Workers Compensation, and Auto if applicable. Keep this up to date and have your insurance agent review this.
- Require them to name you as additional insured on their General Liability Policy
- Have them provide a waiver of subrogation on their Workers Compensation in your favor.

If you hire contractors directly or pay them directly:

- Purchase a contingent workers compensation policy. This will cover you if a subcontractor fails to maintain workers compensation insurance and has an employee injured while working on your property.

- Have a contract with them that includes an indemnity clause in your behalf • Have them provide you with a certificate of insurance for General Liability, Workers Compensation, and Auto if applicable. Keep this up to date and have your insurance agent review this.
- Require them to name you as additional insured on their General Liability Policy
- Have them provide a waiver of subrogation on their Workers Compensation in your favor.

If your contractors or service providers do not maintain insurance it is usually not worth the money you save to take on the risk of having them work on your property.

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