INSURANCE FOCUS

AGING COMMUNITY ASSOCIATIONS

Even though new community associations continue to sprout up throughout the DC metropolitan area, the vast majority of communities in the area have been here for some time. And with older buildings come various problems: leaky roofs, aging water piping systems, and cracked concrete to name a few.

These items are important, not only from an investment standpoint, but also from an insurance standpoint. Aging buildings affect the ability of the community to obtain and/or retain quality insurance coverage at a competitive price. Underwriters are focusing more on life and safety issues as the market continues its adjustments, and carriers for multifamily residential buildings are pulling into and out of the market in response to conditions in the reinsurance industry.

It may be tempting for community association managers and residents alike to "jump ship" and head to newer buildings, but the same problems eventually will surface there, too. And moving entails its own burdens. Many older associations are in desirable neighborhoods, with excellent schools and shopping. Many are centrally located and do not require a long commute to work. Many residents know their neighbors, not just down the hall, but down the block, too, so moving is not an attractive option.

Aging buildings affect the ability of the community to obtain and retain quality insurance coverage at a competitive price.

The solution, then, is not to move to a newer place. The solution is to stay in place and invest some time and money into making the current community association the best that it can be.

Where do we start?

Making sure that a community association will continue to serve its resident well requires planning and perseverance, both by boards of directors and community association managers. The first step is to conduct a risk assessment plan to identify and analyze a community association's exposures. The next step is to use those results to develop a maintenance plan. Sound financial management and knowing when to bring in professional assistance is imperative.

Why is long range planning necessary?

Comprehensive insurance coverage may be difficult to obtain for older communities. Older buildings that are not well-maintained and that lack current safety features, such as sprinkler systems, are especially an insurance challenge. Insurance companies look for community associations that are well maintained, well managed, and financially sound.

Boards and managers of older buildings, then, must make sure that their buildings are maintained with the greatest possible care.

June 2014

Volume 27

Number 3

What is a risk assessment plan?

A risk assessment plan identifies and analyzes a community association's exposures. Community association managers and board members must review and document all general and specific risks of the association.

Community associations have many property exposures. The largest consideration for associations is its real property, such as buildings, signs, pools, lakes, golf courses, piers, and docks. Services, such as valet parking, an in-unit maintenance service, or a shuttle bus, require attention, as do programs such as swim teams, exercise classes, book clubs, day care, and bridge clubs. Common area facilities, including lobbies, hallways, walkways, and parking areas, should be included in the risk assessment plan.

Although our primary emphasis here is property considerations, liability exposures also need to be considered in a risk assessment plan. An example of a liability situation would be a third party legal action against the association alleging negligence resulting in bodily injury or property damage.

The risk assessment plan must take the following into account. Failure to meet the requirements listed in these documents could be seen as a breach of fiduciary duty.

- state and local laws and regulations;
- association declarations and bylaws;
- federal government requirements (such as OSHA regulations); and
- lender requirements.

How do we deal with risk?

Once all of the risks are compiled, the next step in the risk assessment plan is to consider techniques to deal with the risk. Community associations can employ all or some of the following four techniques:

Exposure avoidance: Examples of avoidance include eliminating diving boards, armed guards, swim teams, and alcohol at community functions. Avoidance could mean not undertaking a risk, such as not constructing a children's playground or not serving alcohol in the clubhouse.

Risk transfer: The main method for transferring risk is through purchasing insurance. Another method of risk transfer is hiring a company to perform services such as pool management, landscaping, and janitorial services instead of having community association employees perform these tasks.

Loss prevention/reduction: Activities that reduce the frequency or severity of loss are another way to handle risk exposures. Examples include having "service days" to check washing machine hoses, water heaters, and smoke detectors; checking emergency and exit lights on a regular schedule; and having fire alarm drills. Monetary loss prevention activities include reviewing and reconciling bank statements monthly, having a written policy on signatures, and segregating financial duties.

Segregation of exposures: This entails establishing some type of backup to prevent a loss, such as by making backup files and establishing emergency plans.

ELEMENTS OF THE RISK MANAGEMENT PROCESS

1) Identifying and analyzing exposures
   - property
   - liability
2) Examining alternative techniques
   - avoidance
   - transfer
   - prevention
   - segregation
3) Selecting a risk management program
4) Implementing the techniques
5) Monitoring and adjusting program

How do we develop a maintenance plan?

Once the community association's risks have been assessed, the next step is to develop a maintenance plan for the physical aspects of the community. Insurance companies are looking for a comprehensive plan to deal with the exposures established in the risk assessment.

The goals of a maintenance plan are to avoid unscheduled service interruptions and to maximize the lifetime of the association's equipment. Just as people have their cars serviced at regular intervals, community buildings and components must be serviced on a regular basis.

The first step in developing a maintenance plan is to take a full inventory of the community association's assets that will need maintenance and repair. The inventory should list all common element building components and equipment and assess their condition. The next step is to develop a master schedule that includes preventive, short-term, and long-term maintenance jobs as well as ultimate replacement.

Examples of preventive maintenance include inspecting smoke detectors, fire extinguishers, fire alarm systems, sprinkler systems, generators, and boilers. Additional periodic maintenance could include inspecting washing machine hoses and hot water heaters, checking fireplaces and roofs, and cleaning chimneys and dryer vents.

What are insurance carriers looking for?

Insurance carriers are increasingly requiring community associations to produce a reserve study as part of the insurance application process. They want to make sure that the physical components of buildings are being kept up and that adequate funds are being held in reserve should updates be needed. For instance, roofs are becoming an issue with carriers—they are looking for roofs to be replaced at least every 20 years. It makes good practical sense to make your community association stand out when shopping for insurance.

What do we need to know about financial planning?

Managers and board members must make sure the association has healthy reserves so that the scheduled maintenance and replacement when needed can take place. Emergencies do happen, though, so establishing a line of credit will allow an association to borrow on short notice, if necessary. Professional help is available for conducting reserve studies. (See the "Ask the Expert" column on page 4.)

Should we hire a professional to help?

Many firms and individuals are available to help an association conduct a risk assessment plan and develop a comprehensive maintenance plan. A professional consultant will help an association develop a comprehensive plan and will know all local, state, and federal guidelines.

Where should I go for further information?

Managing and maintaining a community association so that its value is preserved and even increased should be a priority for community association managers and board members. Conducting a risk assessment plan, developing a maintenance plan, and practicing sound financial management are all necessary steps in this process. If you have any questions or need further information, please contact Steve Dickerson (703–205–8788 or Steve.Dickerson@usi.biz) or Theresa Melson (703–205–8753 or Theresa.Melson@usi.biz).

ASK THE EXPERT

"Ask the Expert" is a regular column in *Insurance Focus,* featuring an interview with an expert about an important insurance issue facing community associations. This month our expert is Doug White, P.E., F. ASCE, Principal, Thomas Downey, Ltd., Consulting Engineers, Alexandria, Virginia. Doug has more than 25 years of diversified experience in engineering design of buildings, structural engineering, building investigations, reserve studies, forensic engineering, construction project management and administration, and construction cost estimating. He is a registered professional engineer in DC, MD, VA, PA, KY, and NC. He may be reached at 703–624–2369 or dwhite@TDLengineers.com.

Q: What should I know about reserve studies, and why are they important for underwriting a community for insurance?

A: A reserve study is an assessment of a property's physical plant and estimates of future costs for large repair and replacement projects. The cost projections are used as the basis for a plan to fund the future expenses. Reserve studies are normally prepared by professional engineers or individuals certified as reserve specialists.

As properties age, components wear out and need replacement or renovation. When reserves are not properly funded, as problems develop there is a tendency to defer maintenance and replacement of key infrastructure components because resources to pay for the projects are unavailable. This can reduce the level of service provided by the infrastructure, increase chances of unanticipated failure of key components, and undermine the value of the property.

An illustrative example is the electric power distribution systems in large buildings. The components of complex electric power systems deteriorate over time from normal wear and tear. Moving parts such as switches and relays deteriorate from movement. Cable connections loosen from heating and cooling as the electrical load fluctuates. Insulation on wires deteriorates from heat. Corrosion can affect some metallic components. Periodic preventive maintenance such as infrared scans, physical examination of major components, and tightening connections in panel boxes can minimize problems, but eventually critical components wear out. Over time, the safety and reliability of the power distribution system declines. By the time a system is 50 years old, it is substantially less safe and reliable than when it was new.

To reduce risk, the best plan is to replace key components before they become unsafe. This is expensive and disruptive, but having the funds available makes it easier for management to convince the owners to do the right thing.

Similar scenarios occur for all the major systems in buildings: fire alarm systems, mechanical equipment, plumbing, fire sprinklers, communications, exterior facades, and elevators. Nothing will last forever and none of these systems improve with age. Effective risk management requires assessing the physical condition of these systems, planning for their eventual renovation or replacement, and planning for funding the projects.

In assessing risks at a property, a reserve study can help the insurance professional anticipate potential problems and preparing a plan for addressing them.