



## INSURANCE ISSUES FOR COMMUNITY ASSOCIATIONS

As the need for community association insurance grows, the types of coverage can become very complex. What is right for one community may not be for another. It is very important that coverage be appropriate for the association involved. The following coverages should be part of community association insurance portfolios.

### Property Insurance

In a sense, property insurance is the foundation upon which other coverages are built. Property insurance provides coverage for all buildings, structures, and personal property owned by the association. This will often encompass common property, parkland, woods, open spaces, recreational facilities, buildings, and sometimes portions of residential areas.

In addition to the obvious function of providing protection for loss of or damage to community association property, the board of directors and management should also think in terms of maintaining salability of units and protecting home values.

A community association should first define the areas to be insured. Because of the way ownership and control of common property is divided, this aspect of property insurance can become complicated. State and local statutes under which the community was developed, and the recorded documents of the association, must be carefully reviewed.

Accurate replacement cost valuation of property is essential. In the case of community association buildings, even though it is expensive, it is often wise to hire a professional appraiser. In some cases, the concern of accurate valuation can be eliminated or mitigated by purchasing replacement cost plus coverage. This coverage assures full value replacement, without regard to a coverage dollar limit.

The standard fire policy is the backbone of property insurance. It is the only insurance policy that has been standardized by law. Most states have enacted statutes that specify the language and construction of fire policies. The standard fire policy provides coverage only for the perils of fire, lightning, and removal from endangered premises.

It is by attachment of various forms to this statutory policy that broader coverage insuring against many other perils is provided. Some of these named perils include wind, hail, explosion, riot, smoke, and damage by aircraft or vehicles.



In contrast, the open perils policy provides the association with coverage on its property for all causes of loss, unless specifically named as being excluded. Exclusions typically might include wear and tear, vermin, insects, rust, corrosion, explosion of steam boilers, catastrophic perils such as war or flood, rain damage to the interior of a building, and earthquakes. Optional coverages are usually available for some of these exclusions.

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An open perils policy is preferable to a named perils policy because the coverage provided under the open perils policy is much broader. Under the named perils coverage, it is up to the association to prove the cause of loss is covered by the policy. With open perils policies, all causes of loss are covered, unless specifically excluded or limited, and the burden of proving that a cause of loss is not covered or limited rests with the insurer.

Community association property insurance is written under at least three concepts: bare walls, single entity, and all-in. It is up to the board of directors of a community association, with the assistance of a qualified insurance advisor, to purchase insurance that conforms and complies with all recorded document and statutory insurance requirements.

The most limited form of master policy insurance is called bare walls coverage. This means that common areas and limited common areas are covered—up to the bare perimeter walls, floors, and ceilings of individual units. What is not covered are all items within the interior of these walls, which include fixtures, appliances, interior partitions, wall coverings, floor coverings, cabinetry, and in multi-story units, even the floors, stairs, and ceilings between the lowest floor and highest ceiling.

The most common type of master policy is single entity coverage, which like the bare walls coverage, insures the general and limited common elements. However, this coverage also

extends within individual units to fixtures, appliances, walls, floor coverings, and cabinetry, but only for like, kind, and quality to that conveyed by the developer to the original owner.

In other words, building coverage under the master policy in this type of policy is limited to the original plans and specifications. Any individual unit improvements made subsequent to the original conveyance, such as building a wall to divide a room, or upgrading carpeting or other floor coverings, wall treatments, appliances, cabinetry, etc., are not covered by the master policy. These improvements are the unit owners' insurance responsibility.

A basic purpose of single entity coverage is to assure with a reasonable degree of certainty that sufficient property insurance is purchased and maintained to protect the financial integrity of condominium associations and unit owners.

A less common type of coverage is called all-in because it not only provides for common areas, limited common areas, and individual units, it also covers additions, alterations, improvements, and betterments made at the unit owner's expense.

### Comprehensive General Liability Insurance

In addition to protecting the physical property of the community association, associations must have commercial general liability insurance, which is designed to protect the community association from a wide variety of liability exposures.

Unlike property damage, which can frequently be measured in dollar amounts, liability claims have no limits, other than those imposed by the courts. Juries, never known for their predictability, have sometimes awarded damages in amounts capable of bankrupting community associations.

Commercial general liability insurance covers four types of claims:

1. bodily injury that results in actual physical damage or loss (slip and fall accidents, victims of crime [muggings, robberies, assaults, etc.]);
2. property damage or loss (resulting from the operation, maintenance, or use of common areas);
3. personal injury (false arrest, libel, slander, defamation of character, invasion of privacy); and
4. advertising injury (infringement of copyright, title, or slogan).





Comprehensive general liability insurance can extend liability coverage to any location where association business is taking place. For example, many times an association's annual meeting is held off property at a local fire hall or library, or the association may sponsor a picnic at a nearby park. This policy can extend liability protection to those locations.

With commercial general liability insurance, the insurer typically pays damages, legal defense fees, and case settlement charges.

### Directors and Officers Liability Insurance

Directors and Officers Liability Insurance (D&O) is necessary when the consequence of the board's negligence results in mismanagement of common funds or policies. Typical claims include wrongful termination, sexual harassment, and discrimination.

Because many D&O policies are being written today, it is important to find the one that best fits your association. Some associations have indemnification agreements written into their by-laws, but not all states recognize these provisions. D&O insurance would protect a board member against liability suits should the association fail to indemnify him/her. It should also protect employees and any committee members or volunteers.

Some of the complaints brought against directors and officers of corporations and associations include:

- acts in bad faith;
- breach of loyalty;
- conflict of interest;
- defamation of character;
- discrimination;
- failure to collect assessments;
- failure to maintain property and common areas;
- failure to obtain competitive bids;
- failure to properly fund reserves;
- improper payments;
- libel;
- misleading representation;
- mismanagement of funds;
- poor judgment in the conduct

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- of association affairs;
- sexual harassment;
- slander;
- waste of association's assets;
- wrongful termination/discrimination; and
- wrongful filed lien.

A general category of gross negligence is often cited as a sort of catch-all complaint. The legal costs of defending against any of these charges can be staggering. Some states have enacted legislation permitting non-profit organizations to limit the liability of their directors and officers, but such statutes have not necessarily been tested by the court system.

When looking for D&O insurance, check the exclusion list and definition of insured carefully. Beware of any D&O policy that has an exclusion for prior directors and prior acts. Some policies only cover duly elected directors and officers; appointed board members are not covered. Many policies do not include coverage for association employees and committee members. Discrimination, personal injury, and wrongful termination are often excluded. If the policy has a participation clause requiring the association to contribute in a specified percentage of any loss payment, think twice about that policy.

### Workers Compensation Insurance

Workers compensation insurance provides coverage required by state law for injuries to association

employees and volunteers that occur on the job. Workers compensation laws incorporate four types of benefits: disability (loss of income), medical benefits, survivor (death) benefits, and rehabilitation benefits.

An area of critical importance to community associations is the presence (or absence) of a contractor's workers compensation coverage. A majority of states impose liability on owners for compensation benefits to employees of uninsured contractors or sub-contractors. It is important that such coverage be current, as the association could be responsible for providing workers compensation



benefits if the contractor's insurance expires or is canceled or if the insurer becomes insolvent.

Because there are many issues at stake with regard to workers compensation, it is essential that your insurance representative is capable of determining the correct program for your association, based on local laws and statutes that apply.

### Fidelity Bonds (Employee Dishonesty) Insurance

A primary purpose of a fidelity bond or crime insurance is to indemnify the community association for loss of money, securities, or any property because of any criminal act including fraud, dishonesty, forgery, theft, larceny, embezzlement, wrongful abstraction, willful misapplication, or misappropriation on the part of directors, officers, committee members, association employees, board members, and volunteers. Coverage can also extend to protect the association against criminal acts by an independent managing agent.

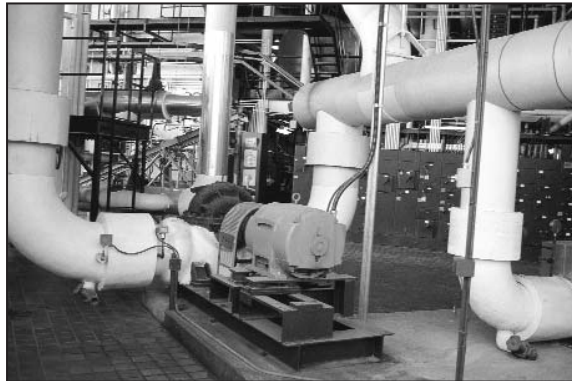
Secondary lenders and some state statutes require condominium associations to maintain coverage with a limit equal to at least three months of assessments plus current reserve funds.

### Automobile Insurance

Automobile insurance is necessary whenever an association has employees who drive cars, trucks, or maintenance vehicles on association property or while carrying out association business. Hired car liability protects the

association against liability from the operation of automobiles that it hires, rents, leases, or borrows. Non-owned automobile coverage protects against liability for operation of autos that the association does not own or hire. Of course, any vehicle owned by the association should also be insured.

Garagekeepers' legal liability insurance is designed to respond when the association has automobiles under its care, custody, and control and when the exclusions of a typical comprehensive general liability policy fail to cover such situations. Typically, this occurs when valet parking is provided.



### Comprehensive Equipment Coverage Insurance

Comprehensive equipment (boiler and machinery) insurance is a form of property insurance that protects against financial loss from property damage, business interruption, and spoilage that is the result of sudden and accidental mechanical breakdown. It fills the gaps left by property insurance policies.

Coverage can extend to all pressure-driven, mechanical, and electrical

equipment including circuitry. Most common equipment failures, such as broken gears, cracked or ruptured pipes (caused by freezing, etc.), and electrical motor burnout, generally are not covered by standard property insurance policies.

The coverage sections are as follows:

Coverage A—Pays for loss of property directly damaged by an accident.

Coverage B—Pays a limited amount for expediting expenses to get equipment back into operation.

Coverage C—Pays for property damage for which the insured might be liable.

Coverage D—Pays for bodily injury, sickness, disease, or death for which the insured is liable. The coverage includes payment for immediate medical and surgical relief rendered at the time of the accident.

Coverage E—Provides legal defense, court costs, interests on judgments rendered, and premiums for appeal bonds for any claim or suit that alleges liability under C or D.

Coverage F—Provides coverage for any object similar to those described in schedule, which insured may install.

Coverage can be written for a specific item such as an air conditioner, or it can be written to cover a number of items on a blanket basis. Limitations should be clearly understood to avoid problems later. In most cases the premium for comprehensive equipment





insurance will be relatively small, but well worth the expense to any association that maintains such machinery.

### Umbrella Liability Insurance

Umbrella liability insurance closes the gap between underlying limits of coverage and possible claims in excess of that coverage. In recent years, it has become common for businesses, associations, and individuals to purchase this type of coverage, partly because today's juries often award huge sums of money to litigants.

Umbrella liability insurance is tailored to each community association, and the risks covered are generally negotiated. Because no "standard" umbrella policy exists, it is important for a community association to work closely with an insurance professional in designing such a policy.



### Fiduciary Liability Coverage

Associations that have pension or benefit plans and trustees to administer the plan should purchase this coverage, which pays, on behalf of the insured, legal liability arising from claims for alleged failure to prudently act within the meaning of the Pension Reform Act of 1974. "Insured" is variously defined as a trust or employee benefit plan, any trustee, officer or employee of the trust or employee benefit plan, an employer who is the sole sponsor of a plan, and any other individual or organization designated as a fiduciary.

Subject to the terms of the policy, fiduciary liability insurance protects the fiduciaries of employee benefit plans for sums they are legally obligated to pay as a result of an actual or alleged wrongful act or breach of their fiduciary duties. The policy can also provide coverage for defense expenses to defend a claim made against the fiduciary for an actual or alleged wrongful act.

### Storage Tank Pollution Liability Coverage

If the association owns an underground storage tank (UST) or an aboveground storage tank (AST), we recommend that a pollution liability policy be purchased.

### Personal Insurance Protection

Personal insurance protection provides the extensive homeowners protection residents need. Many community associations carry master policy coverage on basic structures and common property; however, association insurance does not cover personal possessions. Personal insurance protection provides coverage for

personal property, unit improvements, betterments, additions and alterations, additional living expenses, and personal liability.

### Health Insurance

Group health plans form the backbone of any employee benefits package. Plan offerings vary from traditional indemnity plans to preferred provider organizations (PPOs) and health maintenance organizations (HMOs). Group health plans cover medical expenses in and out of the hospital and prescription drugs.

### Pension/Retirement Plans

Pension plans are one of the most popular employee benefits available. Plans vary from those 100 percent paid by the association to 401(k) plans that allow employees to defer up to 15 percent of their pay.

### Voluntary Benefits

In today's competitive marketplace, voluntary benefits are an excellent way to increase a community association's fringe benefit program while taking advantage of such programs as Section 125-Cafeteria Plans. This is a no-cost way to increase an association's benefits and help hire and retain good employees.

### In Conclusion

Community associations owe it to their members to obtain appropriate insurance for their specific situations. Discuss any questions you might have with your insurance representative or 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” 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 Mrs. Jill M. Cancela-Vaz, ACSR, Personal Lines Premiere Client Services Account Executive of USI. Jill has been a licensed agent for 18 years. She can be reached at [Jill.Vaz@usi.biz](mailto:Jill.Vaz@usi.biz) or 703-205-8774.

**Q:** What are the typical coverages found in HO-6 and HO-4 policies?

**A:** An HO-4 policy, more commonly referred to as a renters’ or tenants’ policy, is designed to protect a tenant who does not have any ownership interest in the property. This policy will provide coverage for his/her personal property should it be damaged by a covered loss, stolen, or vandalized. It will also provide loss of use coverage should the unit become uninhabitable due to a covered loss. This provides the tenant with reimbursement for additional living expenses until he/she is able to move back in.

The policy also provides the tenant with personal liability and medical payment coverage, which provides coverage for bodily injury and/or property damage to others. Some examples would be: should someone come into the unit and slip and fall as a result of the renter’s negligence, the liability coverage would step in to take care of medical bills and treatments; should the renter play golf, and while on vacation, hit someone with a golf ball, the liability coverage would protect him; should the renter be found negligent and leave the water running or cause a fire that damages an adjacent unit, the liability coverage would protect him for the property damage to others. I recommend carrying a liability limit of \$300,000, but preferably \$500,000—the cost between the two is minimal and well worth the added protection.

An HO-6 policy, more commonly referred to as a condominium owner’s policy, is designed to protect an owner who resides in his unit. An HO-6 policy will provide the same coverage as the HO-4 policy with respect to the personal property, liability, loss of use, and medical expense coverage; however, the main difference between the two is that an HO-6 policy will include

“dwelling” coverage at a limit selected by the unit owner. While a unit owner does not need to cover the building, he is usually responsible for any upgrades/betterments or improvements done to the unit.

Condominium owners will want to check with the master policy to confirm this, but single entity coverage is the most common form of coverage. When choosing this limit, a unit owner should consider whether there have been any upgrades to the unit. Should a loss occur, the building will be rebuilt back to its original plans and specifications, so any upgrades would need to be factored in when coming up with a value. For instance, if the flooring was originally carpet, that is what the master policy would be putting back. If the unit owner has hardwood floors, this would be an “upgrade,” and this additional cost would be considered a betterment/improvement and would be covered by the unit owner’s insurance.

**Q:** Is there coverage for payment of the master policy deductible?

**A:** Although there is no simple answer to this question, there are some tips to help make sure that a unit owner is adequately covered. The unit owner will want to select a dwelling limit of at least the policy deductible while also factoring in unit upgrades. He/she will want to add loss assessment coverage, as this will help protect him in the event that he receives an assessment fee by the condo association. I suggest choosing a limit for this coverage of at least \$25,000; this will give added coverage and protect against a costly charge. By using a combination of the loss assessment coverage, personal liability, and dwelling coverage, a unit owner should be protected against the master policy deductible in most situations.