



Insurance Protecting the Association & Board of Directors

MULCAHY Community Association Cheat Sheet®

**BRINGING ANSWERS
TO COMMUNITY
ASSOCIATIONS**

This publication discusses significant points of law as they apply to community associations and is not intended to offer specific legal advice or responses to individual circumstances or problems.

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INSURANCE OVERVIEW

Protecting the community association and board of directors requires a close look at insurance coverage and risk to prevent the coverage gaps that only become obvious after a loss or lawsuit and there is no payout. Begin with the basics. The fewer hazards a property has, the easier it will be to insure. What looks like a risk, is a risk, so minimize exposure or remove the risk if possible.

INSURANCE COVERAGE FOR COMMUNITY ASSOCIATIONS

Directors and Officers Liability Coverage (D&O): Typically covers the board of directors. Common claims include the board's failure to adhere to the governing documents, challenges regarding power granted to the bylaws, challenges to assessments, breach of fiduciary duty and architectural variances, fair housing discrimination and the like. Choose a policy that includes indemnity coverage for the cost of defending actions against the association and specifies that the coverage limit does not include the defense costs; otherwise, legal expenses could eat up most of the coverage. Boards should also be aware that the D&O coverage typically offered to community associations may not cover non-monetary claims for board election challenges, architectural review decisions, rules enforcement, and the like. A mono-line or stand-alone policy is more expensive, but it may cover these non-monetary claims.

Property Insurance: Property damage claims are more common than liability losses. It is not uncommon for boards to set insured loss caps intentionally too low to reduce their premiums, but it is also because boards may not know the value of their community. "Guaranteed replacement cost" coverage is hard to find today. However, most policies do include an automatic inflation adjustment provision, which increases the policy limits annually to reflect increases in area building costs. Boards should have the community periodically appraised and reviewed to be sure the association's policy includes the inflation trigger and that the cost benchmarks the insurer uses are reasonable. Be sure to add coverage for any additions or improvements made since the existing policy was issued.

Fidelity Insurance: Fidelity insurance should be issued in the association's name with the property manager obligated under the association's policy. By structuring in this manner, the insurance will cover a theft by the management company principals as well as by the property manager. The management company will have its own insurance, but that will typically cover the property manager only – it will not cover a theft perpetrated by the management company's owners.

HOW MUCH IS ENOUGH

The Fannie Mae requirement for condominiums (the industry standard) calls for \$1 million in general liability coverage, but in our litigious society a \$1 million policy no longer goes very far. Having enough coverage is critical, and allocating it properly is equally important. The right amount of coverage overall will not help if the policy leaves the association exposed in the areas where protection is needed. Check association documents to ensure the association has the required coverage. Additionally, consult with your insurance agent, manager and attorney to determine how much insurance is enough.

SHOPPING FOR INSURANCE

The board should evaluate basic needs, issue a request for proposals and may want to have an insurance adviser evaluate the bids received. An advisor can explain the similarities and differences, while comparing the costs and coverage offered. Alternatively, choose an insurance agent who specializes in the coverage needed. Note: a good insurance agent should walk the grounds to determine coverage needed and should be willing to meet with the board face-to-face to discuss coverage issues. This is particularly important for community associations, because condominium insurance is complicated and unique and a master planned community may have many, and varied common area amenities. It is important to find an agent who can analyze the association's coverage and make sure it dovetails properly with a unit owners' policy as well as assess the coverage needed for the master planned community.

The association should not treat insurance like a commodity and shop for it based almost entirely on price without considering the nuances that may make one policy, even if somewhat more expensive, a more cost-effective choice than another. It is important to remember that not all policies nor insurers are equal.

PROBLEM AREAS

Insurance coverage to watch closely:

Deductibles: Associations that have increased their deductibles to reduce the association's premium cost and eliminate the small claims that can trigger future increases may threaten future coverage. Associations should consider amending their CC&Rs or adopt a restriction requiring unit owners who suffer damage covered by a condominium master policy to pay the association's deductible – easy for owners to do if they have the deductible coverage that is an inexpensive addition to an owner's policy. Tapping the owner's policy first is less costly for the community and makes the master policy do what it is supposed to do – insure the community against catastrophic losses.

Ordinance or Law: If a building is damaged severely or destroyed, a standard policy might pay the cost of restoring the building to its pre-disaster condition, but it will not cover the cost of making changes an updated building code will require. An association master policy typically excludes losses resulting from “governmental orders”; ordinance or law coverage, which associations can purchase as an endorsement to a standard policy, erases that exclusion and restores the coverage.

Agreed Amount Endorsement: This coverage eliminates the penalty that would apply if the property is under-insured. If there is only \$10 million in coverage on a building that should be insured for \$20 million, the insurer would be required to pay only half of any claim — \$50,000 on a \$100,000 loss. An agreed amount endorsement would ensure full coverage despite that gap.

Business Interruption: If a fire or other disaster forces owners to relocate and temporarily disrupts the collection of common area fees, this insurance would enable the association to continue meeting its financial obligations until its normal income stream is restored.

Non-hired Auto Coverage: Assume that a board member conducting association business accidentally kills someone in an automobile accident. If his/her personal coverage is not adequate to cover the claim, the victim's family can sue the association for the balance. A community association can obtain coverage for this risk.

Workers' Compensation: Many boards overlook this coverage, assuming they need it only if the community employs workers directly, but associations without anyone on their payroll may still be vulnerable to claims. For example, an employee of a contractor hired by the association is injured while doing work for the community. If the contractor does not have the appropriate coverage, the laws in many states will make the community liable for the worker's medical expenses.

Surplus Lines: Watch out for companies writing coverage through “surplus lines,” issued by subsidiaries or affiliates that are headquartered in another state and sometimes in another country. These out-of-state entities are not subject to state insurance regulations, which means they do not have to provide the coverage Arizona requires. Monitoring the source of the insurance coverage is especially important when changing carriers, because dangerous coverage gaps can occur.

INSURANCE TIPS

- ◆ Know the contract dates for the association's insurance policies and assure that they are renewed on time.
- ◆ Read the master policy to ascertain coverage and protection with regard to community needs.
- ◆ Research to determine if your insurer is on solid financial ground and will be there when you need them.
- ◆ Be proactive about risk management. The best way to reduce premium costs is to limit the number of claims filed. Limit claims by being aware, following Arizona community association laws, identifying risks and reducing risk where possible.
- ◆ Eliminate and control possible risks through monthly property inspections, proper maintenance, employee training and resident education. The board of directors should follow the governing documents, state laws and use open business like procedures in board and committee meetings.
- ◆ Even with insurance coverage in place, be proactive. Shop the community's insurance periodically if, 1) there are changes in exposure to risk; and 2) to compare the coverage available. However, if you like the service the current insurer provides, switching to save a few dollars may be a bad idea.
- ◆ Decide what you need first, then compare prices for the same coverage.
- ◆ When changing carriers and/or agents, ask the agent to certify new policy coverage in writing. The statement should include an apples-to-apples comparison, listing the coverage from the old policy, the new coverage and any coverage from the old not provided in the new policy.
- ◆ Establish claims management procedures and follow them.
- ◆ For condominium owners: Educate owners regarding the necessity for individual unit-owners' policies, and consider adopting a rule requiring owners to demonstrate coverage.
- ◆ Insurance Information Institute, www.iii.org, provides definitive insurance information.
- ◆ Arizona Department of Insurance, www.id.state.az.us/index.html, gives specific information for consumers.