

Condominium and Homeowner Association Insurance Issues

Proper insurance coverage is a critical aspect of resort property management both from the individual condominium owner's perspective and from the perspective of the homeowner's association (HOA). The responsibility to make sure that proper insurance coverage is in place is shared by the individual condominium homeowner, their insurance broker, and the HOA and their insurance broker. As a property manager it is important to be aware of the various aspects related to insurance issues, especially when it involves the administration of any insurance claim involving both the homeowner and the HOA. Following is a brief summary of a number of key issues related to insurance that you will want to be familiar with.

A critical element related to insurance that is somewhat unique to condominium developments is the relationship between the condominium homeowners association (HOA) and the individual condominium or unit owner. In order to clearly understand the difference between who is responsible for insuring what portions of a property we need to look at both the condominium declaration (CC&R's) and recent changes enacted by the Utah legislature which further defines the allocation of insurance responsibilities in a condominium development.

One important definition that is contained within the CC&R's is the definition of a "Unit". In its simplest terms this defines what each owner owns. However, as you will see in a moment, this definition does not necessarily indicate what the owner is responsible for insuring as his/her property. Following is a typical definition of a "Unit" that would be found in a HOA Declaration.

Unit: The boundary lines of each Unit are the undecorated and/or unfinished interior surfaces of its perimeter walls, bearing walls, lowermost floor, uppermost ceiling and the interior surfaces of windows and doors. Each Unit shall include any fixtures or furnishing materials applied to or affixed to the interior surfaces of the walls. Also included will be any utility pipes, lines, systems or fixtures, or appliances found within the boundary lines of the Unit and servicing only that Unit. Notwithstanding the fact that they are within the boundaries of the Unit, the following are not part of any Unit; bearing walls, floors, ceilings, foundations, roofs, except their interior surfaces located within a Unit, ceiling equipment, tanks, pumps, vents, ducts, shafts, flues, chutes, conduit, wires and any other utility installations except the outlets located within a Unit.

The above definition clarifies for the Owner and the HOA what the "Unit" owner owns in terms of their condominium. Logically, the next assumption you would make is, based on this definition, the owner is therefore responsible for insuring what he/she owns. However, this is not the case as we will discuss shortly.

Another definition that it is important to understand, which is outlined in the CC&R's, is the definition of "Common Areas and Facilities". This is an important definition because it outlines most of what the HOA is responsible for insuring, but there is one additional insurance requirement that the HOA is now responsible for that is not outlined in the CC&R's. Following is a definition of "Common Areas and Facilities" that would typically be found in the CC&R's.

Common Areas and Facilities: The common areas and facilities are defined to include the land on which the Building is located and all portions of the Property not contained within any Unit,

including, but not limited to, the foundation, columns, girders, beams, supports, main walls, roofs, fire escapes, and any common entrances and exits to the Building; the grounds, the area used for storage of janitorial supplies and maintenance equipment and materials, installations of all central services including power, light, gas, water, sewer, and garbage collection; tanks, pumps, motors, fans, ducts, and , in general all apparatuses and installation existing for common use; any common recreational facilities; any utility pipes, lines or systems servicing more than a single Unit; all ducts, flues, chutes, wires, conduits and other accessories and utility installations to the outlets used therewith; all other parts of the property necessary or convenient to its existence; maintenance and safety, or normally in common use, or which have been designated as Common Areas and Facilities on the Survey; and all repairs and replacements of any of the foregoing.

With the above definitions in mind, from an insurance perspective it is imperative that the HOA and the individual owner have a thorough understanding of whose responsibility it is to insure certain aspects of the Unit and the Common Areas. Previous to the legislative changes that were enacted in June of 2012, the responsibility for insurance paralleled the definitions contained in the CC&R's. In other words the unit owner was responsible for insuring those items defined in the document as the unit and the HOA was responsible for insuring those things defined as common area. Although this made it easy to understand from a theoretical standpoint the practical applications of these definitions were more difficult. Rather than going into the complexities of this issue suffice it to say that the game changed substantially in 2012 when the Utah State Legislature made sweeping changes to the requirements related to what a homeowners association is responsible for insuring.

Based on the new legislation outlined below you will find a detailed description of how insurance coverage is to be placed related to condominium homeowners associations. The new legislation expanded the HOA's responsibility for what it was responsible for insuring to include not only the "Common Areas and Facilities" as defined above but also to include those elements within a condominium that are affixed or attached to the unit. From a practical standpoint "affixed" items would include; carpet, wall coverings, built in cabinets, heating and plumbing fixtures, paint, windows and any other item permanently attached to the unit. Previously, the items outlined above would have been the owner's responsibility to insure through their individual homeowners policy.

The new law goes on to say that "For a covered cause of loss, the Association's policy of property insurance shall provide the **primary coverage, the unit owner's insurance shall be primary for the portion of the loss attributable to the deductible on the Association's policy.** In laymen's terms what this means is the HOA insurance policy will pick up the total expense of a claim for anything above the deductible for those insurable items inside a unit that are owned by the unit but that the HOA is responsible for insuring as outlined above in the preceding paragraph. The law goes on to say that the HOA must "set aside" the amount of the insurance deductible in a separate account so that in the case of an insurance claim the deductible is readily accessible to the HOA.

The next logical question based on the discussion above is; what should the individual owner have in place in terms of insurance coverage? In order to be properly insured under the new law the owner may wish to consider the following types of coverage; personal property insurance (to

include furniture, etc.) liability insurance, loss of use coverage, earthquake (if appropriate and applicable), valuable articles (jewelry, art collectibles etc.), rental loss coverage, and a reasonable amount of building coverage to avoid any gaps in coverage between the HOA policy and the individual owners policy. Typically, an individual condominium insurance policy for a unit is referred to as a HO-6 form so you may hear the individual owner's policy referred to as an HO-6 during an insurance discussion.

In order to complete this insurance discussion we need to now move on to one other important element of the discussion, which is related to the insurance deductible and how it relates to various scenarios related to an insurance claim.

Following are several examples that outline how a claim would be handled.

Scenario # 1- A water line breaks and floods the common area of a building that we have under management. There was no damage to any of the individual units, only the common area was damaged. The total amount of the damage related to the loss is \$34,000. The insurance deductible is \$10,000.

Question: How would the claim be adjusted and who would pay for what?

Answer: The Homeowners Association's insurance policy would be responsible for this coverage. The HOA would be responsible for the deductible of \$10,000 and the balance of the claim (\$24,000) would be covered by the HOA's insurance company.

Scenario #2 - A water line breaks and floods the common area and one of the individual condominiums within the project. The damage was once again \$34,000 and 60% of the damage occurred in the common areas and 40% of the damage occurred in the unit.

Question: How would the claim be adjusted and who would pay for what?

Answer: The HOA policy would provide primary coverage. Because there was damage to both the common areas and a unit, the deductible would be pro-rated per the new law where 60% of the \$10,000 deductible (\$6,000) would be paid by the HOA and 40% of the deductible (\$4,000) would be paid by the owner whose unit was damaged. The balance of the expense (above the deductible) related to the damage would be paid by the HOA policy. (This would exclude any personal property that was damaged inside the unit which would be the sole responsibility of the owner).

Scenario # 3 - A water line breaks on the top floor and floods the common area and three units below it. Again there is \$34,000 in damage but the expense related to damage is apportioned as follows; common area 40%, Unit # 1 suffered 25% of the damage, unit #2 suffered 15% of the damage and unit # 3 suffered 20% of the damage.

Question: How would the claim be adjusted and who would pay for what.

Answer: According to the new law the HOA would be responsible for 40% of the deductible (\$4,000) unit # 1 would be responsible for 25% of the deductible (\$2,500) unit # 2 would be

responsible for 15% of the deductible (\$1,500) and unit # 3 would be responsible for 20% of the deductible (\$2,000) all adding up to the total owed as a deductible of \$10,000. The balance of the claim related to the damage would be picked up by the HOA policy (\$24,000). Once again please note that damage to any personal property would be the responsibility of each individual owner.

Scenario # 4 - (The tricky one!) A water line breaks and floods the common area and two units. The total of the damage is under the \$10,000 HOA deductible. The actual cost to repair the damage is \$8,000. The cost to repair the common area is \$3,000, the cost to repair unit # 1 is \$4,000 and the cost to repair unit # 2 is \$1,000.

Question: How would the claim be adjusted and who would pay for what?

Answer:

When the cost of the repair is below the HOA insurance deductible amount all bets are off so to speak. In this case what happens is each party is responsible for repairing the damage to the property that they own. Therefore, the HOA would have a repair bill of \$3,000, unit #1 would have a repair bill of \$4,000 and unit # 2 would have a repair bill of \$1,000. Coverage from the HOA policy would not be involved in this scenario.

Important Note: This is why it is important for an individual owner to have coverage for what could be their portion of the deductible that needs to be paid and also have basic insurance that covers their property in case a claim occurs where it is under the HOA deductible amount and each owner is therefore responsible for repairing their damage.

Other HOA insurance considerations

In addition to making sure the property insurance is in place correctly there are additional lines of coverage that are necessary in order for a HOA to have proper coverage. These lines of coverage generally include; general liability coverage, a liability umbrella, Directors and Officers Coverage, earthquake coverage, crime, fidelity coverage, auto coverage (if the HOA owns vehicles) among others. Many times the CC&R's will spell out in substantial detail what the requirements are related to the HOA's responsibility to maintain insurance. The best way to fully understand what the insurance requirements are related to a homeowners association is to get with an insurance broker who is experienced in dealing in HOA insurance and ask him/her to sit down with you and explain the policy in detail to you. **Attached as Exhibit __ you will find an "Evidence of Commercial Property Insurance" (Accord) form that provides a summary of the typical insurance coverages you might find in a condominium homeowners association.** In summary, insurance issues related to a condominium homeowners association are very complicated and best left to the experts. When in doubt contact the HOA's insurance carrier for clarification and direction on how to proceed when damage occurs and an insurance claim needs to be filed.