Condominium Insurance Coverage

TAKE TIME TO ENSURE YOU HAVE IT RIGHT

BY DIANE SWERLING

PROPERTY MANAGERS and condominium association boards: always do the necessary due diligence to ensure that your properties have the right coverage. This means understanding what coverage you have, and what you need.

Remember: short money means short-sighted!

Every year, your insurance carrier sends out a "renewal" letter. This is the perfect time to ask the tough questions about your condominium coverage. Here are a few key questions to get you started:

1. **Limit of Liability**

Is your building adequately insured (do you have enough coverage)?

2. **Code Coverage**

Do you have enough Ordinance or Law coverage?

3. **Deductibles**

Do you understand the master policy deductible?

4. **Insurance Application**

Did you take sufficient time to do it the right way? (Don't just gloss over it!)

As a public adjuster, we read a lot of condominium policies, and most of them are inadequate. In fact, under most of the condominium policies we see, any catastrophic property loss would leave the condominium association in dire straits. And we're seeing more and more of these worst-case scenarios—the ones where there is a loss, and not enough coverage.

Why? We know the cost of construction is rising fast—in the Northeast, it's rising at a rate much faster than inflation—and most policies aren't keeping pace with these increases. From a public adjuster's perspective, we can't scream it loud enough: get the right coverage!

Here are a few lessons learned about condominium insurance based on our experience.

LIMIT OF LIABILITY

Most condominium association bylaws state that the association must insure the building for the full replacement cost—but that's not easy to do. The shortfalls in coverage usually stem from the "Cost Estimator" tool used by insurance companies and agents to calculate the estimated cost to rebuild in the event of a total loss. This tool is a static median average of national estimated expenses for various aspects of construction, labor and materials.

The problem with the Cost Estimator is that it's based on wide-ranging averages. Suppose you're in the Boston area, for example. The costs to purchase materials and pay for labor are going to be way beyond what appears from crunching baseline numbers in a Cost Estimator. In markets like Boston, the replacement cost produced by the Cost Estimator is probably one-half of what you will actually need to rebuild.

So how should you determine the amount of coverage you need? This is a global issue, and there is no easy fix. But here are a few suggestions:

Ideally, you'd ask a contractor or other professional experienced in commercial construction for an estimate of actual costs to rebuild. Realistically, most contractors don't have the time or interest to provide such a service.

Alternately, you can hire a professional appraiser—but don't let them focus on market value. Instead, ask for an estimate of the actual replacement cost to rebuild the property with like kind and quality.

Another important issue we have run into deals with reporting requirements. Many condominium bylaws require unit owners to report any improvements or betterments made to their unit. The improvement and/or betterment may be a cost as low as $1,000 based on the verbiage of the bylaws. Unit owners often fail to alert the association of these improvements—even when they affect the amount of coverage for the entire association. Take the case of a 10-unit condominium complex, for example, in which five individual unit owners make improvements of $100,000 each. The limit of liability for that association has just increased by a half-million dollars. This increase can affect all unit owners of the association in the event of an insurance claim.

CODE COVERAGE

Most of the condominium policies that we review contain coverage for Ordinance or Law (a.k.a. "code") coverage. These policies typically have inadequate limits for the code coverage. If you are dealing with an older building in the Boston area, a $250,000 limit of liability for code coverage is not enough.

Our office recently handled a loss in downtown Boston. The condominium association had $1.5 million in code coverage—but still fell short of what they needed to meet today's building codes in the rebuild. This particular building required installation of a fire suppression system throughout the entire building, and all the electrical panels needed size enhancements. The plumbing system of the building, deemed to be in disrepair, also required complete replacement. This meant all new water, drain and vent lines for each unit. It also meant demolition of the areas untouched by the fire, as well as work in the undamaged portion of the building. Every unit owner had to leave the building until completion of the reconstruction work. The final tally on total code-specific repairs: $2 million.

DEDUCTIBLES

In my opinion, the master policy deductible should be as high as possible to dissuade smaller claims, which can lead to either higher premiums or getting dropped by the insurance carrier. Most condominium bylaws are silent when it comes to apportioning how the deductible is managed. I personally believe that the master policy's deductible should be a common expense. However, we mostly see that associations apportion the deductible on a pro rata basis across the damaged units and common areas.

On a pro rata basis, if a 10-unit condominium is affected by a loss, the association will prorate the deductible over the amount of damages. Suppose a burst pipe caused damage to two units and the common area: One unit had $7,000 in damages, another unit had $2,000, and the common area had $1,000 of damage. These two units and the common area would bear responsibility in the amount of 70%, 20% and 10% of the deductible, respectively.

Whether a condominium association treats the deductible as a common expense or prorates it across the damaged units and common areas, unit owners should have coverage for this. At a minimum, unit owners should carry at least the amount of the master policy deductible as a "Coverage A" building limit on their unit owner policies.

INSURANCE APPLICATION

First, a top-line reminder: you need to take the insurance application process seriously! An insurer can deny claims on an erroneous filing of an application for insurance. We have also heard of instances where a building owner could have saved money on safeguards by taking the time to ensure these applications had been filled out correctly.

The application contains several questions, and every one of them must be answered honestly. Don't rely on your agent—do your best to fill it out yourself. We understand that agents may want to help speed up the process, but only you can provide the accurate information.

We handled a claim involving a private residence, valued at $800,000, that burned down. It turns out the responses to every question on the insurance application were incorrect, so the insurance carrier denied the claim entirely. The insurance agent, we later learned, had simply filled in the answers on the client's behalf. Trying to move things along, the agent forged the homeowner's signature, thinking it would never make a difference. In this case, the agent was on the hook for the claim costs. The lesson: fill it out the right way!

It's not always easy to do this. When you're renewing insurance at the last minute, like anything, there's always stress and pressure. Just remember—if something happens, you could be on the hook for it. So, take the time to do it right. CM

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