COMMUNITY ASSOCIATIONS INSTITUTE
BAY AREA/CENTRAL CALIFORNIA CHAPTER

the communicator

Volume 2 • Issue 1
Winter 2009

Does Your Insurance Agent Know Something You Don't?

PLUS

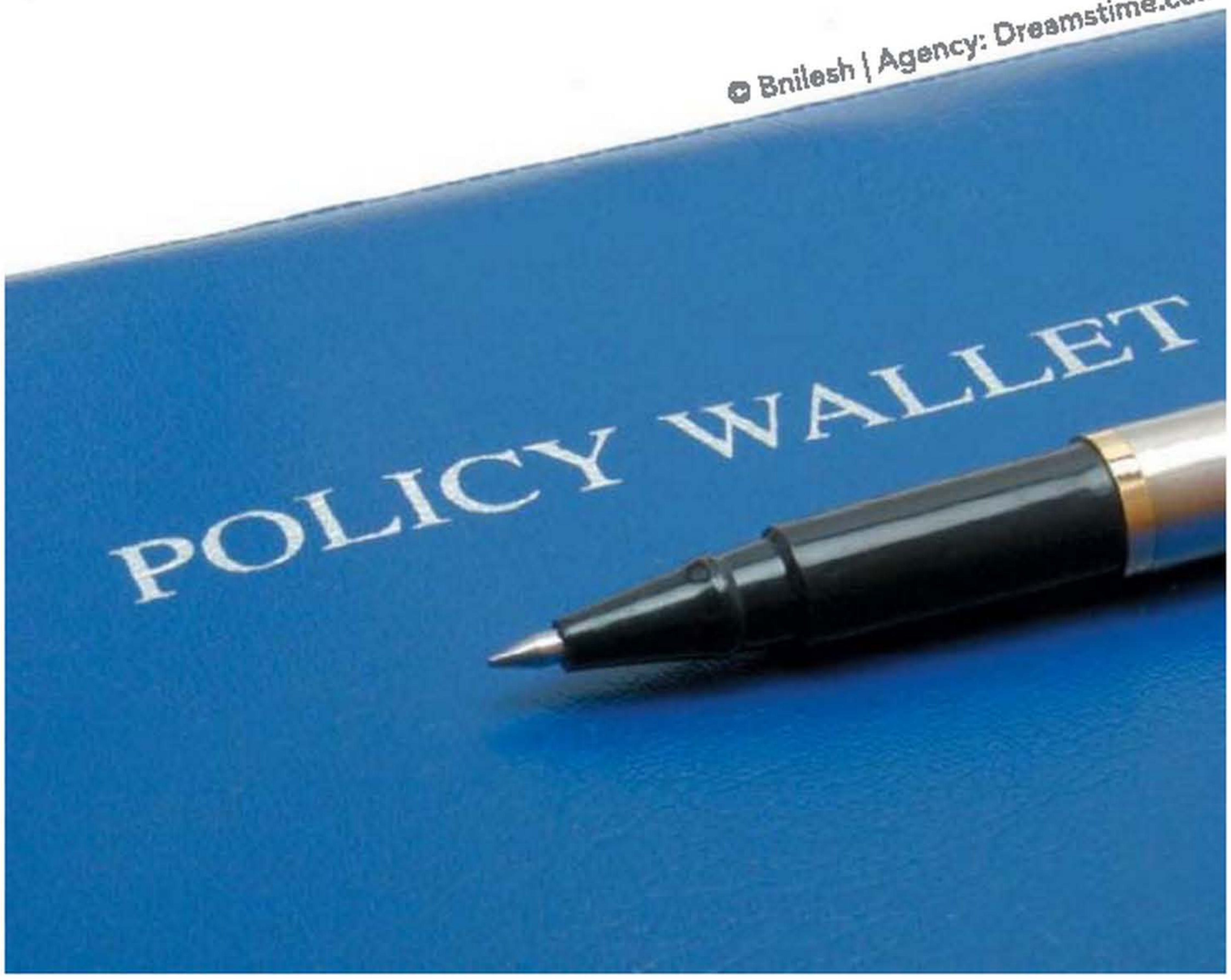
Lien Stripping and Chapter 13 Bankruptcies
The effects on homeowner associations

Mortgage Crisis Impacts Directors
How to stay afloat while property values sink

Does Your Insurance Agent Know Something You Don't?

A checklist for management companies and boards of directors for purchasing required insurance coverage.

By Dennis Socher



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THE INSURANCE INDUSTRY is very competitive; agencies want to sell whatever they can. One basic truth that most insurance agents can agree upon is that, in the common interest development (CID) field, an association should use a specialist.

There are some basic interview questions that the management company or board of directors should ask an insurance agent before asking that agent to quote insurance coverage for a homeowners association — When was the insurance agency established? How long has the account manager/salesperson been licensed? How many homeowner associations does the agency handle? And, do they have any references that are other associations?

During the competitive bid process, we find that many insurance agencies use the word "included" in their proposals to describe some specific types of coverage. "Included" is generally understood to mean something that has come pre-packaged or integrated into a system. The master insurance policy for a homeowners association is generally known as a "package." A good number of package policies automatically include some type of embedded insurance coverage that is the same everywhere, whether the policy is purchased in California or in Florida. Losses covered by this "included" insurance occur from time to time, but they do not offer great monetary exposure to the insured association. For example, most policies include limited coverage for fine arts and furs.

In the area of property and liability coverage, condominium associations, planned development attached dwellings and commercial condominiums are more susceptible to losses related to the following coverage: building ordinance coverage, sewer, drain backup coverage, and equipment breakdown. CIDs in general should utilize a stand-alone Directors and Officers Liability coverage and Fidelity Bond rather than the coverage that is "included" as part of the insurance package policy.

SO WHAT ARE THESE COVERAGES AND WHAT SHOULD YOU LOOK FOR?

Building Ordinance Coverage A, B and C. This coverage is very important

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in the rebuilding process after a covered loss. Building Ordinance Coverage A (contingent liability) provides coverage for undamaged portions of a partially destroyed building. If a building burns, the insurance carrier is only going to provide coverage for the damaged portion. If the fire marshal or a local ordinance requires that the rest of the building be torn down and rebuilt, then if the association does not have adequate coverage limits, the association would have to make up the difference, and the amount could be substantial. Building Ordinance Coverage B (demolition) is self-explanatory, but the amount of "included" coverage is often inadequate to cover the actual cost of demolishing the damaged building. Building Ordinance Coverage C (increased cost of construction) provides for building code upgrades such as adding a fire sprinkler system, hard-wiring smoke detectors or installing a local fire alarm system and handicapped access. Again, if this coverage is not adequate, the "included" amount could be insufficient to cover the rebuilding.

Sewer, drain backup coverage is either not included in package policies or has a low maximum ("included") limit. The lowest sewer drain backup loss we've seen is $7,500; however for a traditional, stacked condominium, the loss could run into the $30,000 range.

Equipment breakdown coverage provides protection for many types of losses. The most common losses for associations are boilers failing and elevator and electronic gate motors burning out. A small number of insurance carriers do actually "include" this coverage within the policy limits, which is a good thing; however, a fair share do not automatically include this and it is up to the insurance agent to add in.

The additional annual insurance premium for the above-mentioned coverage could run up to 25 percent additional annual premium (sewer, drain backup coverage tends to be fairly inexpensive); however, this is money well spent.

Directors and Officers Liability coverage is required by the Davis-Stirling Act (C.C. 1365.9). The law requires $500,000 coverage for associations with 99 units or less and $1,000,000 for 100 units or more. Currently, no insurance carrier offers a $500,000 limit; all carriers offer a minimum of $1,000,000 to homeowner associations, and more coverage is available for an additional premium. Some package policies include endorsements which "add-on" Directors and Officers coverage. However, such add-on coverage is not as broad as the coverage offered by a stand-alone D&O policy.

Every Directors and Officers Liability policy should include Duty to Defend. This guarantees that the insurance carrier will defend the association, even if the loss itself is not covered. The alternative is for the association to hire its own legal counsel to defend the claim; the insurance carrier will get involved only to pay if loss is covered by the insurance. Hiring separate counsel can be expensive; we interviewed many attorneys in the field and most have stated that pre-trial litigation costs can run from $10,000 to $25,000.

Along with Duty to Defend, the association's D&O checklist should include coverage for non-monetary claims and for employment practices liability (for those associations with employees). We recently had a Directors and Officers Liability representative visit our office. She informed us that the most frequent types of D&O claims for CIDs are non-monetary claims. Common examples of non-monetary claims are discrimination, libel, and personal injury.

Lastly, all Directors and Officers Liability policies should include coverage of management. Most association management company contracts require the association to additionally insure management, but most policies do not provide automatic coverage. The association should check to be sure that such coverage exists and, if not, it should purchase a stand-alone policy.

The "add-on" of Directors and Officers coverage to a package policy can cost from a minimum of $200 to as much as $1,100, depending upon the insurance carrier and number of units at the association. The minimum premium for a stand-alone Directors and Officers Liability insurance policy is roughly $675. The difference in annual insurance premium to make this change is only $475 or so, but it can save the association tens of thousands of dollars if there is a loss. There are currently six insurance carriers that offer stand-alone Directors and Officers Liability policies that include all of the above-mentioned coverage.

Fidelity Bonds provide coverage for employee dishonesty. Although most homeowners associations do not have employees and do not even handle association monies, there is loss exposure from the board of directors and management.

Like D&O coverage, this coverage is repetitively "included" by insurance agents as part of the package policy. Most insurance carriers do not offer an endorsement to add the board of directors as non-compensated employees and management; however there are a few insurance carriers that do offer these automatic coverage enhancements. Regardless of the type of policy the association has (included or stand-alone), the policy should be examined to make sure the extended coverage exists. The price difference between a stand-alone Fidelity Bond and the "included" Fidelity Bond is nominal, being around a $200 difference in annual insurance premium. ■

Dennis Socher is a licensed insurance agent/broker in California and Nevada. Socher Insurance Agency has been open since 1983 and specializes in providing insurance coverage for common interest developments. Dennis is currently taking courses for his Certified Insurance Counselor designation. You can visit Socher Insurance Agency at www.hoainsurance.net.