



# F O C U S

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## Property Insurance: An Overview

**F**or community associations, 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 to community association property, the board of directors and management should also think in terms of maintaining

salability of units and protection of home values. Community associations should therefore have appropriate property insurance.

### Where do we start?

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.

Board members should take care to exercise good business judgment in the matter of property insurance, not only because liability for errors will be reduced, but because the

board is ultimately responsible for obtaining the level of insurance that will best meet the association's needs. This is where the support and guidance of a professional insurance agent who is an authority on community association property insurance is invaluable.

### How do we tell what our property is worth?

Accurate 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 guaranteed replacement cost coverage. This coverage assures full value replacement, without regard to a coverage dollar limit.

The board must have a good grasp of the many elements that go into effective property insurance coverage so that misunderstandings and financial loss can be avoided.



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## What is the background on property insurance?

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.

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 insured to prove the cause of loss is covered by the policy. With open perils policies, all perils 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.

## What types of property insurance are available?

At least three types of master policies exist: bare walls, single entity, and all in. It is up to the board of directors of a community association,

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

### IS YOUR INSURANCE UP TO PAR?

The following list may serve as a useful guide to determine whether your present property insurance needs are being met.

Insurable Exposures and Available Coverages	Coverage Afforded	
Accounts Receivable	___ Yes	___ No
Agreed Amount Endorsement	___ Yes	___ No
Back-Up of Sewers or Drains	___ Yes	___ No
Blanket Building and Personal Property Coverage	___ Yes	___ No
Complete Landscaping Coverage	___ Yes	___ No
Contingent Liability	___ Yes	___ No
Damage to Gutters Due to the Weight of Ice, Sleet, or Snow	___ Yes	___ No
Demolition	___ Yes	___ No
Earthquake	___ Yes	___ No
Electronic Data Processing Equipment	___ Yes	___ No
Fences and Retaining Walls	___ Yes	___ No
Fine Arts	___ Yes	___ No
Flood	___ Yes	___ No
Glass	___ Yes	___ No
Guaranteed Replacement Cost	___ Yes	___ No
Increased Cost of Construction	___ Yes	___ No
Loss of Income	___ Yes	___ No
Open Perils Form	___ Yes	___ No
Property of Others	___ Yes	___ No
Signs	___ Yes	___ No
Underground Pipes	___ Yes	___ No
Valuable Papers and Records	___ Yes	___ No
Wind Driven Rain	___ Yes	___ No

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*

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

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the bare walls coverage insures the common elements and limited common elements. However, this coverage also extends within individual units to fixtures, appliances, wall coverings, 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

**“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 Mr. P. Michael Nagle, a principal with the law firm Nagle & Zaller, P.C., in Columbia, Maryland. Mr. Nagle is a charter member of the Community Associations Institute’s College of Community Association Lawyers and represents community associations in Maryland and the District of Columbia.**

**Q:** When damage of a type covered by the master insurance policy occurs to a unit, who should pay the deductible?

**A:** This question often presents a thorny problem for associations because the correct answer erroneously appears to penalize the owner who has already paid his fair share of the cost of the master policy premium. However, it is not really the master policy that is at issue here.

Most governing documents and the relevant statutes in Maryland, Virginia, and the District of Columbia are silent on this question, although community association attorneys are writing insurance deductible resolutions or amendments to documents. These amendments typically apportion payment of the deductible to the person or entity responsible for the maintenance of the thing or area damaged, unless fault is established. Thus, if the unit is damaged through no fault of the association or another resident, the unit owner would pay the deductible. “Fault” requires provable negligence—the mere fact that a common pipe broke, for example, does not indicate fault on the part of the association unless the board had prior knowledge of a problem with that pipe and failed to make repairs in a reasonably timely fashion.

Many people feel that the association should pay the deductible because it has more money than an individual owner. I always point out that the only money an association has is that which it receives from the owners, so everyone in the association

would actually be paying the cost of deductibles. If the deductible is \$2,500.00 and an association has ten occurrences a year, the cost to the owners is \$25,000.00—a sum that would have to be budgeted for by the board each year and paid as a part of the annual assessment or paid via a special assessment. Every master policy has a deductible, and the board is usually under pressure to keep premiums down by having a deductible of at least \$1,000.00.

The answer to this thorny problem is to let the insurance industry pay the deductible. Every owner or resident should have a homeowner’s policy. Many of these policies offer, for little or no cost, a “building coverage” rider that will cover the master policy deductible. Every board should advise the owners in the association to obtain this coverage so that neither the association nor the owners have to pay the master policy deductible. The board should also consult the association attorney concerning the efficacy of an insurance deductible resolution or amendment for that association.

A recent amendment to the Maryland Condominium Act changes this analysis for condominiums (but not HOAs) in that state. In accordance with the revised §11-114 of the Act, Maryland condominiums may only charge an owner the first \$1,000 of a deductible, and then only if the bylaws specifically allow and if the damage originates in the unit. The deductible amount may be collected in the same manner as an assessment.

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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 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.

## What is coinsurance?

Coinsurance is a method of encouraging community associations to obtain insurance in amounts more nearly equal to the value of the property insured, usually specified at 80, 90, or 100 percent. It provides an incentive for adequate insurance-to-value by providing a rate credit for carrying relatively high limits to value. It provides for the full payment, up to the amount of the policy, of all covered losses if the insurance carried is at least equal to the specified percentage. However, if the community association fails to carry the necessary amount of insurance, it assumes a proportionate share of the loss.

Problems arise when community association buildings are insured for a smaller percentage than the coinsurance requirement. For example, if a policy includes a 100 percent coinsurance

clause for a building only insured for 80 percent of its value and a loss of \$100,000 occurs, the association will only be able to collect \$80,000 or 80 percent because of the 20 percent coinsurance penalty.

To avoid this situation, an agreed amount can be worked out with the insurance company, where the association and the insurance company agree on a specific value for a building. This has the effect of removing the coinsurance clause/penalty.

## Who should pay the deductible?

It is important for the community association to determine who is responsible for paying the deductible. For instance, if a fire starts in a unit, who pays: the association or the property owner? The question of who pays the deductible can be answered in at least five ways:

- 1) The property owner who suffers the damage incurs the cost of the master policy deductible.
- 2) If a negligent party causes the damage, the negligent party incurs the deductible cost.
- 3) The association pays the deductible out of common funds.
- 4) The association will make a special assessment for all master policy deductible claims on an annual basis.

- 5) The owner of the unit from which the cause of loss originates pays the deductible. If the cause of loss originates from the common elements, the association pays the deductible.

## Where should I go for more information?

Property insurance is an often bewildering maze to community association boards of directors, managers, and residents. The board must have a good grasp of the many elements that go into effective property insurance coverage so that misunderstandings and financial loss can be avoided.

Although many agents, brokers, and companies offer property insurance, only a few are major players in the complex area of community association insurance. The association's insurance program must comply and conform with all statutory and recorded document requirements and the specific needs of the community association. An agent or broker who specializes in community association property insurance is vital to the protection of the association's assets.

If you have any questions or need further information, please contact Steve Dickerson (703-739-2346 or [sdickerson@usisoutheast.com](mailto:sdickerson@usisoutheast.com)) or Cristy Fuentes (703-684-4366 or [cfuentes@usisoutheast.com](mailto:cfuentes@usisoutheast.com)).

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