INSURANCE FOCUS

AGING COMMUNITY ASSOCIATIONS

Even though new community associations are sprouting up throughout the DC metropolitan area, the vast majority of communities in the area have been here for some time. And with older buildings come various problems: leaky roofs, aging water piping systems, and cracked concrete to name a few.

These items are important, not only from an investment standpoint, but also from an insurance standpoint. Aging buildings affect the ability of the community to obtain and/or retain quality insurance coverage at a competitive price. Underwriters are focusing more on life and safety issues as the market continues its adjustments, and carriers for multi family residential buildings are pulling into and out of the market in response to conditions in the reinsurance industry.

It may be tempting for community association managers and residents alike to "jump ship" and head to newer buildings, but the same problems eventually will surface there, too. And moving entails its own burdens. Many older associations are in desirable neighborhoods, with excellent schools and shopping. Many are centrally located and do not require a long commute to work. Many residents know their neighbors, not just down the hall, but down the block, too, so moving is not an attractive option.

Aging buildings affect the ability of the community to obtain and retain quality insurance coverage at a competitive price.

The solution, then, is not to move to a newer place. The solution is to stay in place and invest some time and money into making the current community association the best that it can be.

Where do we start?

Making sure that a community association will continue to serve its residents well requires planning and perseverance, both by boards of directors and community association managers. The first step is to conduct a risk assessment plan to identify and analyze a community association's exposures. The next step is to use those results to develop a maintenance plan. Sound financial management and knowing when to bring in professional assistance is imperative.

Why is long range planning necessary?

Comprehensive insurance coverage may be difficult to obtain for older communities. Older buildings that are not well-maintained and that lack current safety features, such as sprinkler systems, are especially an insurance challenge. Insurance companies look for community associations that are well maintained, well managed, and financially sound.

Boards and managers of older buildings, then, must make sure that their buildings are maintained with the greatest possible care.

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What is a risk assessment plan?

A risk assessment plan identifies and analyzes a community association's exposures. Community association managers and board members must review and document all general and specific risks of the association.

Community associations have many property exposures. The largest consideration for associations is its real property, such as buildings, signs, pools, lakes, golf courses, piers, and docks. Services, such as valet parking, an in-unit maintenance service, or a shuttle bus, require attention, as do programs such as swim teams, exercise classes, book clubs, day care, and bridge clubs. Common area facilities including lobbies, hallways, walkways, and parking areas should be included in the risk assessment plan.

Although our primary emphasis here are property considerations, liability exposures also need to be considered in a risk assessment plan. An example of a liability situation would be a third party legal action against the association alleging negligence resulting in bodily injury or property damage.

The risk assessment plan must take the following into account:

- state and local laws and regulations;
- association declarations and bylaws;
- federal government requirements (such as OSHA regulations); and
- lender requirements.

Failure to meet the requirements listed in these documents could be seen as a breach of fiduciary duty.

How do we deal with risk?

Once all of the risks are compiled, the next step in the risk assessment plan is to consider techniques to deal with the risk. Community associations can employ all or some of the following four techniques:

Exposure avoidance: Examples of avoidance include eliminating diving boards, armed guards, swim teams, and alcohol at community functions. Avoidance could mean not undertaking a risk, such as not constructing a children's playground or not serving alcohol in the clubhouse.

Risk transfer: The main method for transferring risk is through purchasing insurance. Another method of risk transfer is hiring a company to perform services such as pool management, landscaping, and janitorial services instead of having community association employees perform these tasks.

Loss prevention/reduction: Activities that reduce the frequency or severity of loss are another way to handle risk exposures. Examples include having "service days" to check washing machine hoses, water heaters, and smoke detectors; checking emergency and exit lights on a regular schedule; and having fire alarm drills. Monetary loss prevention activities include reviewing and reconciling bank statements monthly, having a written policy on signatures, and segregating financial duties.

Segregation of exposures: This entails establishing some type of backup to prevent a loss, such as by making backup files and establishing emergency plans.

How do we develop a maintenance plan?

Once the community association's risks have been assessed, the next step is to develop a maintenance plan for the physical aspects of the community. Insurance companies are looking for a comprehensive plan to deal with the exposures established in the risk assessment.

ELEMENTS OF THE RISK MANAGEMENT PROCESS

1) Identifying and analyzing exposures
   - property
   - liability
2) Examining alternative techniques
   - avoidance
   - transfer
   - prevention
   - segregation
3) Selecting a risk management program
4) Implementing the techniques
5) Monitoring and adjusting program

110 South Union Street • Suite 300 • Alexandria, VA 22314 • 703–683–5880 • 800–627–3136 • fax 703–549–1114 • www.usicondo.com

ASK THE EXPERT

"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 Christiaan P. Melson, PCAM, AMS, CMCA, president of CFM Management Services. Mr. Melson has over twenty years of experience in the real estate industry, with a principal focus on the management of condominiums, cooperatives, and homeowner associations.

Q: What steps can a community association manager take to deal with the aging issue?

A: Condominiums, cooperatives, and homeowner associations are such a predominate choice in the housing market today we often fail to realize that most of the growth in this market has occurred in the last 30 years. The first wave of common owned interest housing was the result of the conversion of existing rental housing in or around urban areas. The conversion of the existing product often did not address the components of the properties with useful lives in excess of fifteen to twenty years, as they were relatively early in their lifecycle. Time marches on, and now we are forced to cope with the ultimate reality of having to address the issues related to their replacement.

Items or components included in this group include the following: domestic water piping; closed loop piping for heating and cooling; convectors; electrical wiring; main electric service panels; telephone wiring and service banks; life and safety systems, including smoke detectors, sprinklers, annunicator panels, alarms and pull stations; building ventilation systems; and integrity of firewall barriers.

Most of these components have two common denominators: 1) they are very expensive to replace, and 2) most communities have not set aside funds to address their replacement.

In addition to the basic funding problem, several other issues also become important. Very few managers have any significant experience in these areas other than dealing with preventive maintenance or localized failures requiring partial repair or replacement. Most of this type of work is outside the scope of the managers' contract. The availability of consultants is limited or at least relatively unknown in the community management industry. Insurance companies are now focused on the liabilities associated with life safety systems, water, and mold. Many of these components are subject to extremely stringent code requirements, and many mangers operate under the perception that the last people you want to invite into your community are the inspectors who are responsible for the code enforcement, as violations and/or remedies relate to large expenses.

The future is now, so what do communities and managers do to plan for the inevitability of having to resolve these issues? Communities and managers must first realize the need to confront the issues. In confronting the issues, the managers and communities will have to organize a comprehensive plan involving the loss/control personnel from the insurance companies, and the contractors, consultants, and engineers related to specific components for replacement. In addition, managers will have to become knowledgeable about the appropriate codes and foster a reasonable working relationship with the jurisdictional code enforcement agencies.

Confronting the issues will also require an acceptance for the need to provide funding. This should lead to examining and amending each community's financial plan. These issues will also require communication with the individual members of the association and may require loans or special assessments to resolve.

All communities will ultimately face the issue of aging major component systems. The earlier in the process of aging that the community begins to prepare, the easier it will be to handle the financial responsibility.

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The goals of a maintenance plan are to avoid unscheduled service interruptions and to maximize the lifetime of the association's equipment. Just as people have their cars serviced at regular intervals, community buildings and components must be serviced on a regular basis.

The first step in developing a maintenance plan is to take a full inventory of the community association's assets that will need maintenance and repair. The inventory should list all common element building components and equipment and assess their condition. The next step is to develop a master schedule that includes preventive, short-term, and long-term maintenance jobs, as well as ultimate replacement.

Examples of preventive maintenance include inspecting smoke detectors, fire extinguishers, fire alarm systems, sprinkler systems, generators, and boilers. Additional periodic maintenance could include inspecting washing machine hoses and hot water heaters, checking fireplaces and roofs, and cleaning chimneys and dryer vents.

Should we hire a professional to help?

Many firms and individuals are available to help an association conduct a risk assessment plan and develop a comprehensive maintenance plan. A professional consultant will help an association develop a comprehensive plan and will know all local, state, and federal guidelines.

What do we need to know about financial planning?

Managers and board members must make sure the association has healthy reserves so that the scheduled maintenance and replacement when needed can take place. Emergencies do happen, though, so establishing a line of credit will allow an association to borrow on short notice, if necessary. Professional help is available for conducting reserve studies.

Where should I go for further information?

Managing and maintaining a community association so that its value is preserved and even increased should be a priority for community association managers and board members. Conducting a risk assessment plan, developing a maintenance plan, and practicing sound financial management are all necessary steps in this process.

If you have any questions or need further information, please contact Steve Dickerson (703–739–2346 or Steve.Dickerson@usi.biz) or Theresa Swan (703–684–4369 or Theresa.Swan@usi.biz).

USI • 110 South Union Street • Suite 300 • Alexandria, Virginia 22314
703–683–5880 • Fax: 703–549–1114 • www.usicondo.com
Editor: Shannon R. GaNun

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