

# INSURANCE BASICS FOR CONDOMINIUM ASSOCIATIONS

This is intended to be used as a guide for the association in discussions of these and other matters with your insurance agent. Our guide is not exhaustive, and every association is different. Use it as a beginning tool for further exploration into the important matter of your insurance program. And remember, **choosing the right agent is just as important as choosing the right coverage.**

## Choosing an Agent

Be sure that your insurance agent can answer the following questions. Condominium insurance is complicated and you need a seasoned agent with association expertise.

- How many condo associations does your agent insure?
- Does your agent have a separate and dedicated condo department?
- Is your agent involved with a condominium trade association, such as CAI (Community Association Institute)? It is important that your agent is informed of new issues that affect you.
- Is your agent experienced with new Fanny Mae mortgage requirements?
- Does your agent promptly issue Certificates of Insurance when needed by your unit owners?
- Is your agent willing to attend Board and Open membership meetings?
- Does your agent know the intricacies, as well as the pitfalls, of Directors & Officers' Liability?
- What is your agents Claims Satisfaction rating?
- Do they have a claims staff that works for YOU?
- Does your agent provide you with information to be included in your association newsletters?
- Is your agent familiar with how your Master Deed affects your insurance?
- Does your agent give recommendations for your Master Deed?



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## How to Begin

Step one in an analysis of your insurance program will include a review of legal and lender requirements:

1. Know what state statutes require.
2. Review your association document requirements. Are there specific requirement for liability limits? Is boiler and machinery coverage required? Failure to be in compliance with document requirements could be seen as a breach of fiduciary responsibility by the board of directors.
3. Be familiar with guidelines of lenders such as FNMA. Specific guidelines include those for property and fidelity bond or employee dishonesty coverages.
4. Hire an insurance appraiser to determine the insurance value of the property the Association is responsible to insure.

A review of policies and coverages will begin with the master package policy. This policy can provide a full range of property and liability insurance as well as other coverage parts like boiler and machinery, employee dishonesty, crime, directors and officers' liability and others.

## Property – Scope of Coverage

### Bare Walls:

Provides coverage for common and limited common elements. It *excludes* property within the unfinished interior surface of the perimeter walls, floors, and ceilings of units or private storage areas, additions, alterations and structural repairs, finishes, coating and coverings of walls, floors and ceilings, and permanently installed appliances and fixtures.

### Single Entity:

Provides for common elements, limited common elements, and property included in units and private storage areas with were initially installed in accordance with the association's original plans and specifications or a replacement of like kind and quality.

### All In:

Provides coverage for common elements, limited common elements, property included in units and private storage areas and additions, betterments and improvements made at the expense of the unit owner. *Excludes* contents.

## Valuation of Loss

### Replacement Cost:

Allows for recovery of a loss on the basis of actual replacement without regard for depreciation. Property values are considered on the basis of new for old, subject to a specific policy limit.

### Guaranteed Replacement Cost:

Allows for replacement cost with no limit. The coverage form will not state a specific property limit and allows recovery of a loss to be whatever the replacement cost is at that time.

*“Replacement Cost does not pay more than the policy limit.”*

### Actual Cash Value:

Allows for the cost of new materials at the time of the loss, plus labor and other charges, less depreciation for wear and tear, use and obsolescence.

### Blanket Coverage:

Enables a number of objects of insurance (buildings and/or contents) to be grouped together and insured for a single amount.

### Agreed Amount or Agreed Value:

Coverage which waives any coinsurance clause in the insurance contract and eliminates the possibility of a coinsurance penalty if property is not insured to value at the time of loss.

Note that some policies have no coinsurance clause and are automatically written on an agreed value basis.

### Increased Cost of Construction:

As a property ages, it will become subject to updated building codes. In the event of a loss, reconstruction may be required to meet current codes. For example, a sprinkler system in a building or handicapped facilities in a restroom may be required for re-building.

## Causes of Loss Covered (Perils)

### Special Form:

This coverage form is also known as “all risk” and provides protection for all perils *except* those specifically excluded. While the special form is the broadest available, there are many variations in perils excluded, such as: sewer back-up, artificially generated electrical current or mysterious disappearance for property of others. Standard exclusions include flood, earth movement, war and military action, nuclear reaction and material factors such as wear and tear, rust, corrosion, deterioration, hidden or latent defects, settling, cracking, bulging, shrinking or expanding.

## Causes of Loss Covered (continued)

### Contingent Liability from Building Laws:

Also known as *Building Ordinance or Law - Coverage A* - Coverage for Loss to the Undamaged Portion of the Building.

To understand this coverage, one must recall that the special form, replacement cost policy will repair or replace those items damaged by the peril of fire, wind, etc. However, if a regulatory authority condemns a whole building rather than allowing the repair or replacement of the damaged portion of the building, the total building is lost. Contingent liability coverage is needed to rebuild the undamaged portion of the building while the standard policy form will rebuild the damaged portion of the building.

### Demolition Costs:

*Coverage B* - When the Contingent Liability clause becomes operative, the undamaged portion of the building must be razed before it can be rebuilt. Demolition cost coverage affords this protection.

## Items of Property

The association's review of property covered should examine what items are covered, for what perils and for what coverage limits.

### Buildings:

Could include residences, club houses, meeting centers, boat houses, carports, garages, sewage treatment facilities, and heating and air conditioning plants. Could also include foundations; pipes, wires, conduits and utilities whether above or below ground; heating, ventilating and cooling systems, sprinkler, fire protection and security systems; permanently installed building machinery and equipment; balconies; porches; decks; and patios.

### Structures (these items may not be insurable):

Could include arbors, awnings or canopies, bridges, bulkheads, cabanas, courts for handball, courts for racquet sports, flagpoles, fences, walkways, roadways, fountains, gatehouses, gazebos, piers, docks and wharves, pump houses, recreation fixtures, retaining walls, swimming pools and statues.

## Items of Property (continued)

### Other Property (items may not be insurable):

Could include antennas and satellite dishes, electronic data processing equipment and software, fine arts, indoor and outdoor furnishings, glass, personal effects, property of others, property off premises, signs, and trees, plants and shrubs.

## Additional Property Coverages

### Loss of Income:

Provides coverage to replace the lost income during the period when damage to the premises or other property prevent this income from being earned. For example, loss of maintenance fees when a unit is damaged by fire.

### Extra Expense:

Provides coverage for the additional expenses needed to continue the operations of the association following an insured loss. The expenses of a temporary office, phone lines and equipment rental would be an extra expense.

## Primary Liability Coverage

Liability coverage insures against third party claims arising from alleged bodily injury or property damage to members of the public. The insurance company has the duty to defend the association against any claim which alleges injury or seeks damages regardless of whether the association is negligent.

A comprehensive general form is preferred as it covers all operations of the association and is not restricted to the association's premises. Extensions of the coverage could include:

### Additional Insureds:

Provides employees and property managers acting within the scope of their duties the same liability protection afforded to the association.

### Advertising Liability:

Protects the association against injury arising from advertising activities including slander, defamation of character or libel.

### Contractual Liability:

Provides coverage if the association has entered into any contracts where it agrees to indemnify or hold harmless the other party.

## Primary Liability Coverage (cont.)

### Cross Liability:

Provides protection if an owner or member of the association sues the association for bodily injury damages occurring on a common area as a result of negligence by either a unit owner or the association.

### Garagekeepers' Legal Liability:

Provides protection for the automobiles of unit owners or guests that are in the care, custody or control of the association, such as attendants that part cars. Coverage is provided for such perils as collision, vandalism and theft.

### Host Liquor Liability:

Provides coverage for liability that may arise if the association sponsors events where liquor is consumed or served.

### Independent Contractors Liability:

Protects the association from loss due to liability arising from operations of sub-contractors. (Many carriers now exclude or limit this coverage.)

### Medical Payments:

Provides medical expense coverage for people injured on the common property whether or not the association is liable.

### Personal Injury:

Extends bodily injury to include false arrest, detention or imprisonment, libel, slander, malicious prosecution, defamation of character, invasion of privacy, wrongful eviction and wrongful entry. Some forms may also include coverage for humiliation and discrimination.

### Property Damage:

Provides coverage for the association for property of others in the association's care, custody or control at the time of loss. Some forms limit coverage to the peril of fire only.

### Severability of Interest:

Precludes the insurance company from denying liability because of negligent acts of the association or a unit owner.

## Liability Limits

### Occurrence:

An occurrence means an accident that results in injury or damage neither expected nor intended from the standpoint of the insured.

### General Aggregate:

The general aggregate limit is the most the insurance company will pay for any and all liability occurrences or losses under the policy during any one policy year.

## Umbrella Policy

The umbrella liability policy provides coverage in excess of general or primary liability and other coverages which could include automobile liability, employers' liability (workers' compensation), and directors and officers liability.

An umbrella policy becomes effective when primary or underlying limits have been exhausted, or for some not covered by an underlying policy.

*"When you consider that D&O insurance protects personal assets of board volunteers, who would risk not having it?"*

## Directors and Officers Liability

Directors and officers liability provides protection against claims alleging loss arising from mismanagement or wrongful acts. A wrongful act means any breach of duty, neglect, error, misstatement, misleading statement, omission or other act done or wrongfully attempted by the association.

## Scope of Coverage

### Claims Made Form:

Provides protection for claims made or presented to the insurance company while the policy is in force, without regard to when the event occurred. Most policies today are written on a claims made form.

### Full Prior Acts:

Protection for losses which occurred before the policy inception on a claims made coverage form. Full prior acts coverage eliminates a retroactive date.

### Retention:

Amount of claim payment for which the association is responsible. The retention may be in addition to a policy deductible.

### Persons Insured:

Should include the association; directors and officers, past and present (elected or appointed); employees, committee chairs and members; and other association members acting at board direction.

## How It Pays

### Indemnity Contract:

The insurance company will indemnify the association for any costs for which the association becomes legally liable. The association is responsible for hiring and paying legal counsel until indemnified by the insurance company. Indemnification may not occur until the claim is concluded.

### Pay on Behalf of Contract:

The insurance company will choose legal counsel, handle the claim, and pay any costs for which the association becomes legally liable including costs of the defense.

### Defense Costs:

Determine whether defense costs are included in the policy limit or are paid in addition to the policy limit.

## Exclusion Review

The coverage provided by directors and officers liability forms varies greatly. The extent of coverage provided or not provided can be determined by reviewing policy exclusions.

Those exclusions may include:

- Failure to maintain adequate insurance.
- Non-monetary damages (the most common type of D&O claim today).
- Discrimination.
- Injunctive Relief.
- Wrongful Termination.

Some D&O policies will defend you and pay awards for claims that arise out of employment practices such as sexual harassment, age discrimination, etc.

*“Building association reserves takes time but losing the reserves to theft may not. Implementing solid money control systems and purchasing adequate fidelity insurance protects everyone.”*

## Employee Dishonesty (Crime/Fidelity Bond)

Employee dishonesty coverage indemnifies the association for loss of money, securities, or any other property due to acts of fraud, dishonesty, forgery, theft, larceny, embezzlement, wrongful abstraction, or willful misapplication or misappropriation, or any criminal act.

Coverage is provided only for the association's employees, unless it is specifically broadened. Directors and officers of the association and employees of the property management firm who handle association funds should also be covered. Association documents and/or FNMA guidelines may specifically require that coverage be broadened.

## Additional Coverages:

Additional policies or coverages which the association's exposures may require or desire include workers' compensation, employee benefits liability, boiler and machinery coverage and automobile liability. The basics of these coverages are outlined below.

## Workers' Compensation

Workers' compensation insures against claims for work related injuries or diseases suffered by employees that are compensable by statute and/or imposed by law as damages. Coverage is provided for payment of medical expenses and reimbursement of lost wages.

Coverage should be considered even if there are no regular employees. Protection may be needed in the event the association employs casual labor or if the association hires an independent contractor who has no insurance coverage. In addition, coverage may be desired for board members and volunteers. Coverage should include a voluntary compensation endorsement for these exposures.

## Employee Practices Liability

Employee benefits liability provides coverage for errors and omissions which may occur in the administration of the association's employee benefits program. Usually written on a claims made form, the coverage will respond, for example, when in the event of an administrative error an employee is not added to the group health policy and the employee or covered family member suffers a serious illness or accident.

The association should establish whether this coverage is subject to a retroactive date, deductible and/or an aggregate policy limit.

## Boiler and Machinery

Boiler and machinery (Equipment Breakdown) coverage provides coverage for exposures which are normally excluded in the property coverage form. Boilers, pressure vessels and mechanical equipment including compressors, pumps, fans, blowers, engines, turbines and wheels can be covered for mechanical breakdown perils. Most boiler forms will provide coverage for individual heating and air conditioning units, as well. Loss of income and extra expenses incurred as a result of a mechanical breakdown can also be covered.

## Automobile

This coverage is needed for the operation of motor vehicles. A policy includes liability coverage for protection against third party claims arising from alleged bodily injury or property damage to members of the public. Coverage may also be provided for medical payments, collision, comprehensive perils and non-owned and hired autos.

If the association has no owned automobiles, non-owned and hired automobile coverage should still be secured. Often these coverages can be included on the master package policy. The coverages are described below:

### Non-Owned Automobile:

Provides protection against the exposure of the association from liability for operation of autos that it does not own. For example, a claim could be made against the association when an employee is involved in an auto accident while on association business.

### Hired Automobile:

Protects the association from liability for operation of automobiles that it hires, rents, leases or borrows.



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