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Austin Chapter community Associations Institute

What's All The Fuss About?
The Association Master Policy

by Russ Blancken

Every year community associations' elected officials and committee members are tasked with overseeing that the association's needs are met and its functions are running smoothly. Perhaps one of the most important roles in serving in these capacities is that of being on the insurance committee or being involved with the decisions made each year regarding insuring the master policy of the association. Not having the coverage or amount of insurance needed can have huge financial consequences for the association and its members.

Insurance Valuation

How would you respond to this question? In the following example, which building needs the most property insurance? You are a property manager charged with helping your association clients with their insurance programs. There are two properties coming up for renewal with exactly the same construction type and quality, they share the same layout, square footage and zip code. The market value of one is $10M and the market of the other is $5M. The only difference is one is located next to a park and the other is located next to a dumpy bar. The answer is they need the same insurance values as the replacement cost is the same. As an agent for the past 17 years, this situation is one of the most common misunderstandings in insurance. Insured values for property have to be based on replacement value, not market value or tax appraisals.

So how do you know what your insured replacement value should be? A good start would be to find and work with an insurance agent who specializes in insuring condos and larger properties. Most agents use an industry standardized replacement cost estimator to calculate replacement values. The most common is Marshal and Swift, an internet-based software program that updates replacement values by zip code quarterly based on the building dimensions, construction type and amenities. A focused agent will probably also keep a close relationship with area builders to cross check these values. The insurance carriers have their own specific guidelines for insuring to replacement value and a co-insurance requirement. As agents we inform our insured of the carrier's co-insurance requirements and can assist in the estimation of replacement values but ultimately it is the responsibility of the insured to decide what replacement values they are comfortable with in the event of a total loss.

A consequence of not keeping up with your insured values could come to involve something called the co-insurance clause of your property insurance policy. How would you and your association members like to find that a covered loss to your property is not paid in full because of a co-insurance penalty?

To illustrate co-insurance, suppose your property is insured for $17M and you have a fire and your property sustains $600,000 in losses. You would think you would get a check for $600,000 less your deductible, right? Maybe not. Before the insurance company pays the claim, among other factors, they will evaluate the insured value versus replacement value to determine if the co-insurance requirements have been met. These co-insurance requirements vary by carrier and policy. Most require 80%, 90% or 100% co-insurance values. Let's assume in this scenario the replacement cost is $20M. Because you are not insuring the property for at least 90% of its replacement value or $18M, the insurance contract would not be met and a co-insurance penalty would result. Because the amount of coverage to meet the co-insurance clause of the policy (should) have been at least $18M and your limits of insurance were $17M (did) you will only receive 85% (did/should) of the damage amount less your deductible. So of your $600,000 loss, only $510,000 (85% of $600,000) less your deductible would be paid from the insurance carrier. The only saving grace in this example was that it was not a total loss. If that were to occur, not many of our associations and their unit owners could make up the $3M deficit to rebuild the condo complex.

One of the most important roles in serving your community is that of being on the insurance committee or being involved with the decisions made each year regarding insuring the master policy of the association.

On the other side of this issue is being over insured. Most insurance carriers build an inflation guard into their policies to help avoid co-insurance issues and keep up with replacement value. This means they will automatically increase your property values a given percentage each renewal to keep up with inflation associated with increased construction cost. Depending on the carrier, the inflation factors used are between three and six percent. In most situations this is a good safeguard to keep up with increased cost of replacing your buildings. But let's suppose the policy you have has a five percent inflation guard and over a three-year period the actual replacement cost only increased two percent annually. So three years go by without any one reviewing your coverage with you or the association. At the end of the three-year period you could be almost 10% over insured. That can mean a lot of extra coverage and premium that did not need to be paid for.

Deductibles – Be aware!

Because of the severe wind and hail losses our state has been dealt in the past three years, many insurance carriers have restructured their deductibles programs or raised premiums and some did both. Unfortunately, unless you read the fine print and understand the verbiage you may not realize some of the differences. What seems like a great renewal premium with a few deductible changes made by the carrier on your next renewal or a competitive bid could mean a not-so-nice surprise the next time you turn in a claim for wind or hail damage. This past year I have seen this exact scenario. Your property renewal comes in and it's higher than last year, so you shop it and you end up going with a much lower-priced proposal. The property deductible is still $5,000 but you were not aware that the wind/hail deductible on this proposal is five percent - per building. Think about that. If you have a $500,000 building, that would be a deductible of $25,000. What if more than one building has damage? When you get a proposal, you really need to ask about the deductibles, not only the amount of deductible but the actual endorsement or have the agent state the terms of the deductible in writing. A percentage of the insured building versus a set deductible and per claim versus per building is a difference worth knowing.

Unit Owners

Property insurance can be complicated enough but insuring condos is a world unto its own. The replacement values we are discussing become a bit blurred when we throw in the dynamics of insuring the unit owners based on the governing documents of any given association. It's imperative that your association insurance committee, the unit owners, your property management team and your insurance agent have a good grasp on what the governing documents state as to who is responsible for replacing (insuring) what in the event of a loss. Your agent should want to have a good look at the association's governing documents before offering an insurance proposal. Unfortunately, there is no industry standard for what is the responsibility of unit owner's versus that of the master policy – it's all about the governing documents of the association. Another fallacy in our industry is the terminology used to describe these requirements. Walls in or studs out, etc. may or may not reflect the actual requirements of the associations' governing documents. It's imperative that the governing documents be as clear as possible and those charged with insuring these risks, be knowledgeable of the governing documents and the insurance coverage needed.

(Continued on page 54)

(Continued from page 51)

And We Are Not Done Yet ...

There's a lot to grasp if you want to insure your association properly. In this article we touched on some basics. You should also be looking at the coverage you do or don't have for items like AC compressor or the pool pump – could that be insured for mechanical breakdown. What if you have an older condo complex? Would your old construction format fit the new laws and ordinances? What if you have to replace the walls with 2"x6" from your prior 2"x4" walls? Or maybe the new ordinance states the building has to be retrofit with fire sprinklers, (Ordinance and Law Coverage).

The bottom line is you need to make sure your association insurance committee members, your property managers and anyone else that is making the decisions for your insurance are aware of the choices they have available. Working with an agent with experience and expertise in insuring associations and larger properties is a good start.

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