

Is Your Association Properly Covered?

Insurance is always a timely subject, but it can be confusing too. How much does the Association need? Is it too much or is it too little? What results if the Association is not covered properly can be devastating to everyone either as a result of the actual loss and/or as a result of the special assessment that may be needed if the coverage is not sufficient to cover the loss.

So, let's start with some basics. Property insurance covers losses arising from damage to buildings and personal property. The policy protects against causes of loss such as fire, lightning, windstorm or hail, vehicles and theft. In addition to the Property policy there are specialized policies which cover losses resulting from Flood, Earthquake and Equipment Breakdown. The broadest property form is a Special Cause of Loss form which is an all-risk form covering most perils except those specifically excluded such as flood and earthquake. A Named Peril policy will provide coverage only for the perils specifically named in the policy such as fire, lightning, windstorm or hail, smoke, damage to property by vehicles, vandalism, sprinkler leakage and water damage.

There are three types of loss settlement valuations. Replacement cost pays the cost of replacing your property without deduction for depreciation. Extended replacement cost pays a certain amount above (Generally 120% or 125%) the policy limit to replace a damaged building after a major disaster when the high demand for building contractors and materials can push up the normal cost of reconstruction. Actual Cash Value provides the current costs to replace, less an allowance for depreciation. Agreed Value policies are one wherein the insurance company agrees, in advance, that the coverage limit will be considered the insured value. When you obtain an insurance policy, the coverage limit established is the maximum amount the insurance company will pay in the event of a loss. The policy limits should be evaluated at each renewal period to ensure your Associations are carrying adequate limits of insurance and meet the coinsurance requirements.

This is a good time to ask, "Are you adequately covered?" Most commercial policies contain a coinsurance clause that may leave the Condo Association or HOA holding the ball if you miscalculated their insurance needs. The basic principle behind coinsurance is to make sure the Owner is insuring the property to an adequate value. If the Owner is found to be carrying inadequate levels of insurance, they will be required to bear a portion of the loss themselves. Coinsurance means that the policy is permitted to carry only a percentage, usually 80-90%, of the buildings full replacement value. It is a method of providing equity in premiums by granting lower rates to those who accept the responsibility of insuring for amounts which reflect a high percentage of the value of the subject property.

Coinsurance varies based on the amount of loss, the replacement value of the building at the time of the loss, and the amount of coverage purchased. The basic formula for determining adequacy of limits is:

"Actual amount of insurance (amount carried) divided by Required amount of insurance (amount you should have carried) \times the Amount of loss = Amount Insurance will pay.

Let's assume you have a building appraised* at \$250,000. Under an 80% coinsurance clause, you would be expected to insure 80% of this value or \$200,000. Now let's consider the two scenarios, ***the amount of loss in each case is \$50,000.***

- (1) In the first scenario, the owner only carried \$150,000 in coverage on the building. \$150,000 (bought) divided by \$200,000 (should have bought) \times \$50,000 loss = **\$37,500 (Amount insurance company will pay)**. The out of pocket required of the owner (Association) through "self-insurance" to fund the shortfall is \$12,500.
- (2) In the second scenario, the Owner carries the full \$200,000 required under the Policy. \$200,000 (bought) divided by \$200,000 (should have bought) \times \$50,000 (Loss) = \$50,000. The amount the Insurance Company will pay.
In this example, the Owner would get a full recovery under their insurance policy for the loss incurred.

As you can see by these examples, coinsurance can have a major effect on what you can expect to be paid in the event of a claim. *The next most important step in determining value is to have an insurance appraisal done. The small amount spent for an appraisal, may save the Association thousands of dollars in out of pocket expenses and will provide the board with the advice of an expert on which they can rely when exercising their fiduciary responsibility to the members.

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