It's Coming... Hurricane Season
The Preparation Starts

June 1st marks the beginning of Hurricane Season. There is a lot to do and to think about before then, so let's start with one of the most important subjects – Insurance.

Your community's insurance coverage is one of the most critical issues the Board has to deal with. All points of coverage should be reviewed annually to ensure the Association is adequately covered. The Board has a fiduciary obligation to use its' best efforts to obtain adequate coverage, including flood insurance. Insurance coverage should not be a question of affordability, especially if the community has any exposure. If you are not sure what is needed or why, ask your insurance agent to come to a meeting and explain the current policy coverage and what other coverage may be needed. Ask questions and make sure the community's dollars are being spent for maximum protection in compliance with the replacement requirements in your documents or state statutes.

Some questions to be asking about your insurance are:

- Do we have enough coverage? How is replacement cost determined?
- Do we need a property insurance appraisal?
- Does the policy cover the cost required to upgrade the buildings to code in case of destruction?
- Does it cover debris removal?
- What perils or cause of loss does it cover?
- What is a Named peril? What is an Open Peril?

- Under what condition is water damage covered? What constitutes flood damage?
- Why do we need flood insurance?
- What covers loss of landscaping, fencing, screening, exterior building paint, building foundations, walkways, pools, tennis courts, satellite dishes?
- What does General Liability cover?
- What is Property Displacement?
- What is Ordinance or law exclusion?
- What are the deductibles and when do they apply?
- What does the policy require us to do in the event of a loss?
- What type of records and documentation will the insurance company want to see in the event of a claim?

There are three types of insurance coverage:

- **Replacement Cost**: pays the cost of replacing property regardless of depreciation or appreciation.
- **Extended Replacement Cost**: will pay the coverage limit if the costs for construction have increased. This generally will not exceed 25% of the limit.
- **Actual Cash Value**: provides replacement minus depreciation.

When obtaining an insurance policy, the coverage limit established is the maximum amount the insurance company will pay out in case of loss of property. The amount will fluctuate if home or condos are rising in value; the amount needs to be in step with the actual value of home or condo.

Most commercial policies contain a coinsurance clause. The basic principle behind coinsurance is to make sure the property is insured to an adequate value.

If the association is found to be carrying inadequate levels of insurance, the association will be required to bear a portion of the loss. Coinsurance means the policy is permitted to carry only a percentage, usually 80-90% of the home/building's full replacement value.

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

"Actual amount of insurance (the amount you purchased) divided by Required amount of insurance (the amount you should have purchased) X 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) x $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) x $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.

Starting to plan for the coming season is a prudent first step. There is much more that is needed. We will be providing additional information in the coming weeks that may take the form of either direct communication and/or electronic postings that may help your community and the owners to better weather the storm and the aftermath.

*As noted above, one of the most important steps 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.

We would like to thank Insurance Office of America, Sandy Lewis for the examples used to demonstrate coinsurance coverage and losses.