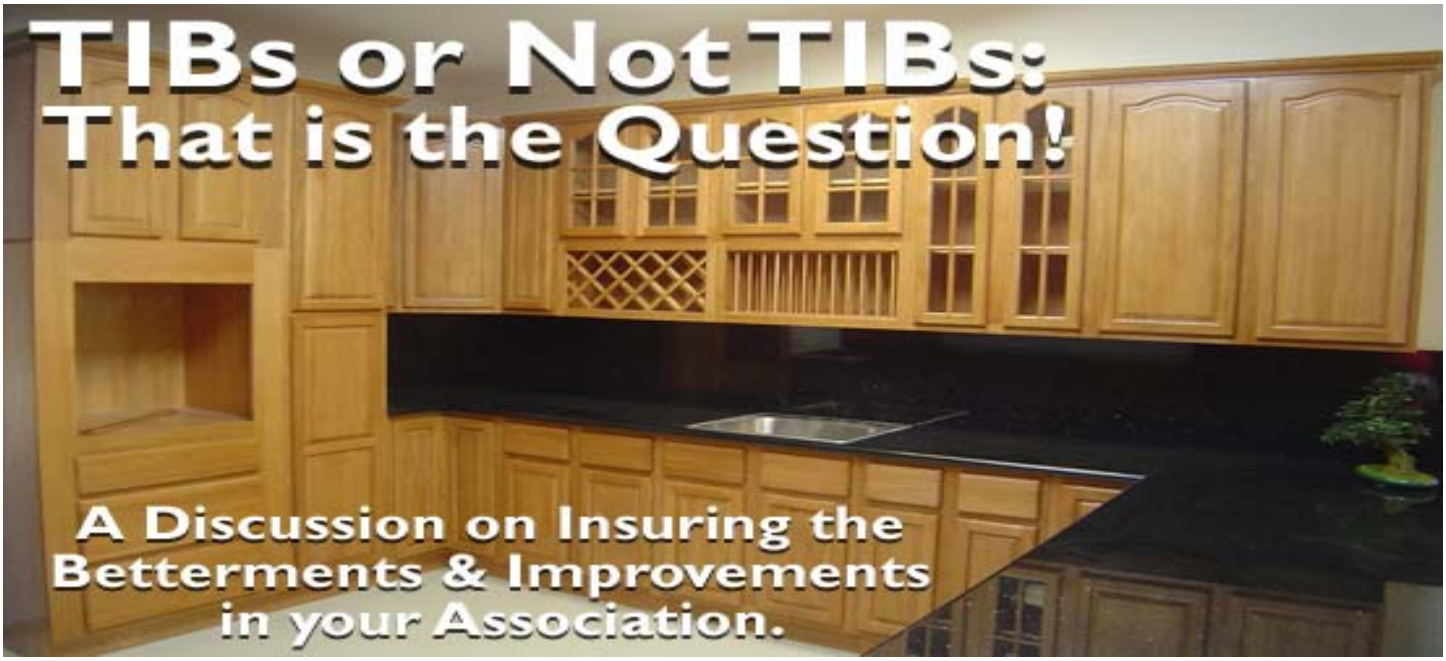

Perhaps one of the most overlooked and misunderstood pieces of an Association's insurance puzzle is the property coverage provided for Tenant Improvements & Betterments (TIBs) also referred to as Unit Owner Improvements & Betterments (UOIB) on some insurance policies.

As the words suggest, these terms are used to describe structural betterments & improvements made by a condominium unit owner to the interior of their unit. These improvements could have been made at any time after the building was built, by any of the unit's (potentially various) owners, but they constitute an alteration from the original builder's specifications. Why does this matter?

Well, there are four different ways a master policy can be written:

1.) Bare Walls Policy

Coverage is only provided to the common area of the building up to the drywall of the exterior walls of the unit but not including the finished surfaces and/or interior walls of the structure. As the title indicates, this is the sparsest form of coverage.

2.) Original Builder's Spec's

Coverage is limited to that property which was originally included in the "units" as they were initially constructed. Under this type of policy, the building(s) would be rebuilt in accordance with the condominium's original plans and specifications. This is a little broader, as it does affirm some coverage for interior fixtures and "built-ins," but this form could still impose significant limitations depending on the age of a building and the improvements that have been made by subsequent owners.

3.) All-In Policy Per CC&Rs


Most carriers are unwilling to offer coverage for any property which the Association does not own or for which they are not explicitly responsible. So they will offer coverage to the extent required by the Association's governing documents – only that property which the Association is obligated to maintain, repair and replace will be covered.

4.) All-In Policy Regardless of CC&Rs

These are the broadest policies available, offering coverage for all Fixtures, Improvements, and Alterations that are a part of the building or structure, including floor coverings, wall coverings, fixtures, cabinetry, and built-in appliances such as those used for refrigerating, ventilating, cooking, dishwashing, and laundering, on a "REGARDLESS of OWNERSHIP" basis. In other words, all interior fixtures and built-ins that become a permanent part of the real estate – most anything that would not fall out, were you to turn the building up-side down and shake it – would be covered, no matter the language in the CC&Rs.

It is up to the Board to choose which type of policy is right for each Association. And their options may be limited, depending on the availability of these products and on the Association's budget. It may behoove the Board to have a conversation with the HOA's attorney to first determine exactly what the CC&Rs require the Association to insure. If you find that, like most governing documents out there, your CC&Rs are ambiguous at best, you may consider having your attorney amend them to provide a clear determination of what items are the responsibility of the Association versus the responsibility of the unit owners.

If it is available and affordable for your Association, you may want to consider a policy which provides the "All-In" coverage *regardless* of the CC&R limitations. This would eliminate the need to sift through the CC&Rs to determine maintenance responsibilities and would provide the broadest form of coverage available to all of the units uniformly.

Now, there are some self-proclaimed "insurance experts" who will insist that the policy you purchase must *exactly match* the Association's CC&Rs. However, most governing documents are clear that insurance guidelines represent the *minimum coverage* a Board must maintain, and put the purchasing of any additional coverage at the Board's discretion. As an example, many sets of CC&Rs don't require coverage for the peril of Earthquake. Does this mean that the board would be in violation of the CC&Rs if they purchase Earthquake Insurance for their Association? Absolutely not.

It's sufficient to say that the intent of any CC&R minimum insurance requirements is twofold: (1) to protect the property values within the development; and (2) to protect the interest of any first mortgage holders (or secondary lenders such as Fannie Mae or Freddie Mac).

If you agree that the Board's first obligation is to protect the property values of the real estate, is it really in the Association's best interest to have unit owner betterments and improvements excluded, if coverage is available to include them for a competitive price?

The California Department of Insurance's "2010 Residential Market Study" indicates that only 11.82% of residents in California have their own homeowner's policies. Is that true in your Association? If so, that means that 88% of your neighbors have no individual protection to supplement the Master Policy.

If there were a fire or earthquake at your Association, and 88% of your neighbors didn't have the financial means to rebuild their units to the standard they were before the loss, you can bet that property values in your Association are going to drop. Even if 50% of the owners don't have a personal lines policy to repair their unit, that's a significant portion of your Association that will be dragging your property value down. And one could argue that NOT purchasing a policy with broader coverage when one was available to the Association was in conflict with the Board's obligation to maintain the property value of the Association.

Furthermore, when it comes to Earthquake insurance, the coverage available to the individual unit owners under the CEA is severely limited. The California Earthquake Authority only offers a maximum of $25,000 for interior built-ins. Anyone that's ever remodeled a kitchen or bathroom knows that $25,000 may not be enough to cover one room, let alone an entire condominium or townhouse.

Now, it's true that most earthquake and fire insurance carriers only provide coverage for UOIBs per the Association's maintenance and repair obligations as set forth in the CC&Rs – and even that potential extension of coverage must be endorsed onto most policies. But there are a few carriers out there (for both Fire and Earthquake perils) that will offer this broader coverage form regardless of the CC&Rs.

Now that we've all seen (courtesy of the mortgage meltdown) what short sales and low "comps" in a community can do to property values, a Board of Directors may owe it to themselves and their neighbors to explore obtaining the broadest protection available to them.

When it comes to property values, the saying "less is more", just doesn't apply.

When "Values" matter…

A propane grill is suspected in this devastating $3 Million fire loss at a 36-unit building at Plumwood Terrace Condominiums on Saturday, July 10, 2011.

Perhaps one of the largest exposures a Board of Directors may face is the possibility of being underinsured. After any catastrophe, individual unit owners (and perhaps even the Board) will question, "Do we have the right coverage?" and "Do we have sufficient limits?"

Ironically, this is the one area where the Board, itself, may have no insurance protection.

The Board's neglect in purchasing the right coverage or properly estimating the accurate replacement cost for the project can often result in the immediate depletion of the HOA's reserves coupled with large special assessments against the individual owners to help cover the shortfall. Particularly in this economy, it's likely some owners retaliate and sue the Board to challenge the special assessment alleging the Board breached their fiduciary duty for failing to purchase sufficient coverage. Unfortunately even the best Directors & Officers Liability policies specifically exclude coverage for errors the Board may commit in obtaining the right insurance coverage.

In other words: There's no insurance for failing to purchase insurance.

In order to benefit from the protection of the "Business Judgment Rule," the Board should rely on the advice of a third-party professional. In the Lamden case (Lamden v. La Jolla Shores Clubdominium Association), the Court stated: "We hold that, where a duly constituted association board, upon reasonable investigation, in good faith and with regard to the best interests in the community association and its members, exercises discretion within the scope of its authority under relevant statutes, covenants and restrictions, to select among means for discharging an obligation to maintain and repair a development's common areas, courts should defer to the board's authority and presumed expertise."

The Court deferred to the Board's presumed expertise, even if the decision is ultimately proved to be wrong. But what is reasonable investigation? That's where third-party professionals come in.

The most conservative approach to valuation of the Association-owned common area improvements is to hire a professional real estate appraiser to prepare a "replacement cost" valuation. Check to make certain your appraiser has the appropriate experience and credentials and, most importantly, maintains adequate Errors & Omissions insurance.

By Ryan Gesell,
CIRMS

**Timothy Cline
Insurance Agency,
Inc.**

For more information please visit us at: www.timothycline.com

or call us today at: (800) 966.9566