



BIG 'I' VIRTUAL UNIVERSITY

Risk & Reality Report

CRACKING THE CONDOMINIUM CONUNDRUM



Independent Insurance Agents
& Brokers of America, Inc.

TABLE OF CONTENTS

INTRODUCTION	2
THE “CALLS”	3
INFORMATION REQUIRED TO PROVIDE PROPER PROTECTION	3
TWO KEY PROPERTY QUESTIONS	4
FOUR REAL PROPERTY DEFINITIONS	5
THREE LEVELS OF ASSOCIATION RESPONSIBILITY	9
PROPERLY EXTENDING REAL PROPERTY COVERAGE FOR THE UNIT OWNER	16
THE NFIP “MUDDIES” THE WATER	16
MANAGING VALUATION METHODS	18
MANAGING THE LIABILITY EXPOSURE	26
APPENDIX A – CONDO LAWS BY STATE	31
APPENDIX B – JOINT AND SEVERAL STATES LISTING	32
ABOUT THE AUTHOR	33

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INTRODUCTION

Condominiums – I know, it's everybody's favorite subject.

Before we jump in, I want to mention a couple of things up front just to make sure expectations of what's to come are what they should be. Some of the things we're not going to be discussing are any specific coverage form or endorsement or the Directors and Officers (D&O) exposure.

This is more a discussion of concepts – what you need from the very beginning, what you need to know up front before you even start looking necessarily at coverage, and what you need in order to structure the condominium program for either the association or the unit owner.

Let's take a look quickly at our “Cracking the Condominium Conundrum” agenda. First, just to get us in the mood, we're going to talk about a couple of phone calls that you might receive or even phone calls you might make yourself.

From there we'll turn to the information that is required to provide the proper protection, and what we'll talk about that several times throughout this document, is that it's fascinating that once we know what one party needs, we know what the other party needs. As I mentioned, I might say that a few times here. Then we'll introduce two key property questions that must be properly answered in order for you to design the condo property coverage.

In fact, we'll spend most of this document talking about these two questions, and how to answer them, and I'll go ahead and tell you what they are up front – who owns what and what is it worth, in other words, what's the valuation procedure? Answering these two questions is where we'll spend the majority of our time here.

The next two agenda items go together. We'll be talking about the four real property definitions that apply to condominium coverage. We'll combine that with the three levels of association responsibility to answer the question that I already mentioned, “Who owns what?” Then, we're going to answer a question that I never really thought I would ever have to answer.

We'll next discuss how the NFIP muddies the water, so to speak. Then we'll turn our attention to our second question, “What is it worth,” where we'll discuss the evaluation and managing evaluation methods that might apply to a condo association and unit owner.

This is a quite an interesting discussion given the apparent improper use of terms that you might see in the governing documents or maybe in statute, but maybe the misuse isn't intentional. I'm not quite sure about this, but you'll see what I mean when we get there.

We'll end our discussion talking about managing the liability exposure or, more specifically, who we're going to assign blame to if somebody gets hurt. So let's begin.

THE "CALLS"

Let's start with our phone calls. As I said, you might make these phone calls. You might receive these phone calls. Just to give you an idea of where we are in the beginning of this discussion.

Our first phone call, "We're purchasing a condo unit at the Silver Lining Condos, and we need to get insurance in place. Can you give us a quote?"

You might also get this call, "Hi, my name is Hugh Kelalie. I'm a board member with Silver Lining Condominiums and we are looking for a new insurance program. Can you help us?"

Now I'm sure you probably answered both questions with, "Absolutely, we can help you," but for some reason, if both of these people called you in the same day, you may have treated them differently in regard to the information you requested before actually providing a quote.

Maybe we do this because of the difference in commission levels. I'm not accusing, just making a statement. Maybe it's because some of us don't realize that we actually need the same information for both situations regardless of whether it's the unit owner or association calling. Regardless, you need the same information. Hopefully, after reading this document, you'll see the reason for my being such a stickler about this and the need for you to ask for the same information regardless of who the client is.

What do you need? Let's jump right into it.

INFORMATION REQUIRED TO PROVIDE PROPER PROTECTION

What do you need to properly write coverage for either the unit owner or the association? First of all, you need a copy of the association's declarations, bylaws, coverage, conditions and restrictions, whatever. Basically, you need their governing documents. You need to know what rules they are playing under.

With that being said, you also need an official letter documenting the definition of a unit's boundary – we'll talk about why that's important in a moment – and who is

responsible for insuring which property. As I mentioned already, we'll define the various types of property, and the various property definitions that apply to condos in just a moment.

Why do we want this letter? Why does this seem to be a necessity for writing condo coverage? A few of us, me included in that few, are likely qualified to answer who's responsible for which property, because it's a legal question to some extent.

Now we can probably make a pretty good estimation based on how it's written. It might look pretty clear, but assumptions create problems, and at the same time, if you have done something improper for the association or the unit owner, you could have an errors and omissions (E&O) issue on your hands. Therefore, you want an official document saying this is who's responsible for what property, even if you think the associational documents are absolutely clear. I hate to assume and you should, too.

Disappointment is a function of expectation, and if the unit owner or association expected something and you didn't give it to them, they're going to be disappointed, which leads again to an E&O problem.

Next, you need a copy of the applicable state statute – we'll talk about why this is important as we go along in this document – or you at least need access to this information.

You may not have to have the pages on your desk, but you need to be able to access the information. At the end of this document is an appendix with a list of every state condo statute and a link directly to those various statutes (see [Appendix A](#)).

Then you need a verifiable or signed property valuation calculation, mostly for the association, because you want to make sure you're insuring the property to the right values.

Remember, as I said before and will probably say another 17 more times, you need to collect the same information regardless of who the customer is, whether it's the unit owner or the association, because when we're writing property insurance coverage for either a condominium association or a unit owner, we have to remember there are, to some extent, competing interests. Their interests aren't mutually exclusive; in fact, if you really think about it, they're complementary. Where the interest of one party ends, the interest of the other party begins.

TWO KEY PROPERTY QUESTIONS

When the association is no longer responsible, the unit owner becomes responsible and vice versa. The problem is defining the point where the interest in property changes from

the association to the unit owner and vice versa. When it stops being the unit owner's responsibility it becomes the association's responsibility. That's why it's so important to have all of that information and why we ultimately have to answer two key property questions when we're dealing with either the unit owner or the association.

The first question we have to answer, as I eluded to earlier, is “Who owns what” or rather who is responsible for what property. This is a puzzle we have to piece together, and it's essentially based on two key factors.

The first factor is the meaning and the description of the four real property terms found in either the association's governing documents or in statute. We combine that with the level of association responsibility spelled out in the governing documents, or again, statute, if it's not dealt with in the governing documents. Remember, it doesn't matter who you're dealing with, if it's the association or the unit owner, because when the responsibility of one ends, the other begins.

Our second property question is "What is the value" or, more specifically, "What is the valuation method being applied to the insured property? What's it worth? What's it worth in insurance terms?"

Now whoever the insured is, association or unit owner, and whatever constitutes “insurable property,” again, relating back to responsibility, value can have different meanings based on the governing documents or statutes if not defined in the governing documents. You have to compare those to the valuation methods found in the insurance policy itself. This will make more sense when we get to that question a little later and go more in depth on that question specifically as it relates to values and valuation.

FOUR REAL PROPERTY DEFINITIONS

Let's start answering the first question by looking at just a few definitions of real property as it relates to condominiums. Understanding these four real property definitions is absolutely necessary to discover who is responsible and assign coverage for who is responsible for what property in the condo situation.

These definitions, as I've said already, are found in one of two places. They're either found in the governing documents of the condo, or they're found in the relative statute if they're not covered in the governing documents.

The four property definitions that we're going to take a look at are:

1. Common elements
2. Limited common elements

3. Unit property and unit improvements
4. Betterments

Common elements is real property owned in common by and beneficial to all members of the association. This can include land and parking lots which are probably covered or may not be covered under the insurance. It can sometimes – and I stress the word sometimes – include foundations and load bearing walls. We'll see why I say “sometimes” in just a moment.

Common elements can also include clubhouses, pool houses, pools, fences, gates, playground equipment, tennis courts, and basically any other real property that's owned by the association and allocated to all unit owners. Generally, the definition specifically excludes unit property when you see the definition of common elements. Remember that common elements are common – meaning they are assignable to all unit owners.

Then we have limited common elements. These are real property elements that are generally – but not always – beneficial to more than one but less than all or even a large portion of the unit owners. These can include structural foundations and load bearing walls. But if you remember, I just mentioned foundations and load bearing walls in the common elements. Here's an explanation of how this is possible.

If you have one building, structural foundations and load bearing walls are a common element because every unit owner benefits from them. If you have two or more buildings, the foundation and load bearing walls in one building only benefit the tenants of that building. The foundation and load bearing walls become essentially limited common elements. These can include, as I said, structural foundations and load bearing walls when there is more than one building.

Other examples of limited common elements include things like common hallways or corridors that provide access to several units; walls or columns containing electrical wiring, sprinkler piping, or a plenum enclosure and ductwork for heating and air systems servicing several units.

Beyond the fact that sometimes limited common elements generally includes real property that benefits several people, there are situations when a limited common element is an element that only benefits one unit member such as steps, stoops, decks, porches, balconies, patios, exterior doors, and windows that again serve only that one unit owner but are outside what we define as the unit boundaries.

Those are considered limited common elements. So now we've covered common elements and limited common elements, and next we have unit property.

As mentioned earlier, unit property is essentially a function of the definition of unit boundary generally found in the governing documents and if not there then in the condo statutes of the state (see [Appendix A](#)).

Unit property benefits only the unit owner and mostly commonly includes the inside of exterior unit walls, interior partition walls but not load bearing walls – remember that these are limited common elements – counter tops, cabinetry, plumbing fixtures, and any other real property confined to and solely used for the benefit of the unit owner.

The problem with the definition of unit property is that there's no one universal definition of unit boundary. Because of that, there are a lot of different parts of the building that could be assigned to the unit owner as unit property within the unit boundary. We'll talk about this more a little later when we get into some examples of Covenants, Conditions, and Restrictions (CCR) language as it relates to this topic.

That's the reason why you have to look at the governing documents or the statutes or get a legal opinion because you have to know, when you're dealing with unit property, who is responsible for unit property and to what point in the building.

When do the interests of the unit owner begin and end, and when does the association pick up? There's no one specific definition of unit property. It varies. You have to know how that association defines it or how that statute defines it if the association doesn't address it.

We've covered common elements, limited common elements, and unit property, and now we'll move on to unit improvements and betterments.

Unit improvements and betterments are included, to some extent, within the broad scope of unit property, but we have to separate it out for coverage purposes. We have to separate unit property from unit improvements and betterments for coverage purposes which you'll see in a moment. Put simply, this type of real property is created when the unit owner upgrades the unit. When they replace the carpets and put down hardwoods, when they go from a laminate counter top to a granite counter top, when they upgrade the cabinets – whatever they do, it is above and beyond what every other unit has; it is customized for the owner because they love hardwoods, they love cherry cabinets, etcetera.

Whatever it is that the unit owner does that is different than the rest of the association or how it was designed originally, it's an improvement or betterment to that unit that benefits only that unit owner. Let's look at a few examples so you can visualize what we're talking about as it relates to these four common property elements definitions:

1. Common elements



Remember, common elements are owned in common by all unit owners. You see the building here that has the foundation that's all common elements. Tennis court, tennis fence, pool house, those are all common elements.

2. Limited common elements



This hallway, a limited common element, leads to several different units. Now look at the balcony. The balcony benefits only the owner but it is outside of the definition of the unit boundaries, in other words, outside of the unit property. Because of that, it becomes a limited common element.

3. Unit property



Next is unit property. Unit property is all the real property that's inside the unit that benefits who? Nobody but the owner of the unit.



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