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Homeowners' Associations

by [David Thompson](#), CPCU

Many people today are looking for ways to simplify their already too complex lives. One method to accomplish this goal is to purchase a home or townhome in a homeowners' association, thus reducing the amount of time required for "mundane" chores such as cutting the grass, painting, and making major repairs to the typical single-family, stand-alone home. Along with the advantages though, come some disadvantages—insurance being one of them. It's very unlikely that many purchasers of a townhome or a stand-alone home in an association ever consider the insurance implications of such purchase. Only when it's time for the agent to provide coverage, does the issue surface. This article examines some of the insurance aspects of owning homes in a homeowners' association.

Condominium or Homeowners' Association?

Of key importance in structuring insurance coverage for any risk is knowing what the risk really is. There are two main types of associations, with important differences that are not obvious to the untrained eye. While a "condominium association" and a "homeowners' association" do have things in common, they are considerably different on several key points. For example, here is a recent e-mail sent to FAIA:

Have you ever heard of there being any real difference between homeowner associations and condominium associations? I have a condo unit owner that says they are set up as a homeowners' association, but that the documents are "like" a condo association. I know that the statutes are very clear regarding what a condo association is responsible for. Is there anything similar for a homeowners' association?

From an insurance perspective, it's either a homeowners' association or a condominium association—it can't be both; the only way to know for certain is to read the association documents. Once a determination has been made as to the organization, then insurance coverages can be structured. It's critical that a correct determination be made at the time the policy is written, since many residents (and even some association boards) may not know how the body is legally organized.

Types of architecture/ownership.

Some individuals may feel that since the structure they purchased "looks like a townhouse," then they purchased a townhouse within a homeowners' association. While the structure may architecturally look like a townhouse (multi-story, several units in a building, possibly separated by firewalls), it could be legally organized as a condominium association under the corporate documents.

In a true condominium, the ownership is vested in the unit owner who owns: (1) the air space in the individual unit; (2) an undivided interest with all other unit owners in such common elements as the building structure, land, recreational facilities, and the like; and, (3) certain property attached to the building within the unfinished perimeter walls, floors and ceilings.

In a homeowners' association, individuals own their property on a "fee-simple" basis, meaning that only they own their house or townhouse and the ground below. There is no common ownership of any part of their dwelling or townhouse.

Florida Statutes.

Once a determination has been made as to the legal organization of the association, it is necessary to consult the Florida Statutes to see what, if any, statutory mandates for coverage exist. The statutes differ for condominium associations and homeowners' associations.

Condominium Associations: Chapter 718 of the Florida Statutes dictates coverage issues for condominiums, and they spell out in detail a list of items that must be insured by the condominium association. The statutes outline a wide variety of issues and requirements for condominium associations, including the stipulation that the association documents must be filed with the Secretary of State's office. If condominium documents conflict with a Florida Statute, then the statutes prevail.

Homeowners' Associations: The provisions of Chapter 720 of the Florida Statutes regarding homeowners' associations are nowhere near as extensive and specific as those for condominium associations. Notably, there is no stipulation or guidance on the insurance issues for homeowners' associations. This can be both good and bad, depending on what requirements individual associations come up with. In fact, many insurance provisions in homeowners' association by-laws are often difficult or impossible to meet. Lacking any statutory mandate for coverage, the sole source for insurance matters in a home association becomes the association documents.

Insurance Issues.

While there may be numerous ways to structure coverage for homeowners' associations, it likely boils down to three basic options:

- One master policy, covering all of the building items, combined with tenant homeowners (HO-4) policies for the residents.
- Individual policies (HO-2, HO-3, HO-5, or HO-8 type) for the residents, and no master policy.
- A combination of a master policy covering portions of the building, with the association documents making residents responsible for some building items under their own homeowners policy.

Suffice it to say, regardless of which way insurance coverages are structured, there will be

advantages and disadvantages associated with the method. The following is a discussion of the three options presented above. For the sake of discussion, assume that the homeowners' association is made up of one building, there are ten separate fee-simple units, separate firewalls, and each unit has a replacement cost of \$200,000. The same coverage analysis below could just as easily be applied to a homeowners' association composed of ten separate stand-alone, single-family, fee-simple homes.

One Master Policy Covering All Building Items

Overview.

In a homeowners' association or subdivision, the homes (single family or townhome) are individually owned in fee-simple and are not collectively owned by all members of the homeowners' association. Therefore, when a homeowners' association seeks to put in place a "master policy" covering all homes, several fundamental problems may arise.

Given that Chapter 720 contains no clear guidelines or requirements for insurance, this leaves the individual homeowners' associations to devise insurance programs of their own choosing, often with little real understanding of the consequences. Insurance requirements that homeowners' associations devise may often be patterned after the insurance program used by condominium associations, and, as has been discussed earlier, these are "two separate beasts," and requiring different methods of structuring coverage.

The association's documents and bylaws may state that the association shall obtain property insurance for the replacement cost of all of the buildings. In such case, the Insurance Services Office (ISO) Building and Personal Property Coverage Form (CP 00 10) would be appropriate, and coverage should be structured to reflect an amount of coverage adequate to rebuild the entire building. Items such as the roof, interior and exterior walls, built-in cabinets, wall-to-wall carpet, tile, windows, and doors should be included. It would not be appropriate to use the ISO condominium form (CP 00 17) for a homeowners' association. This would especially be true if the Florida specific endorsement (CP 01 91) were attached to the CP 00 17. The Florida endorsement excludes various items from coverage—items such as carpet, interior paint, floor tile, water heaters, and cabinets to name a few. If the bylaws required the association to insure these items and the CP 01 91 were attached to the policy, a serious coverage gap would be present. The CP 00 17 should be used only for a true condominium association.

Insurable interest.

Some carriers may resist the "single master policy" concept, citing the lack of insurable interest. Unlike a condominium, no one has a direct insurable interest in an individual home except the homeowner (and his mortgagee). With a master policy in which the homeowners' association is the named insured, a potential conflict is created. While insurable interest may be created by a variety of methods, contracts being one, some carriers may be unwilling to write one policy in the name of the association when individual townhomes or homes are owned fee-simple by individuals.

Advantages.

This "single policy" approach does offer some advantages. Assuming the association obtains and maintains an adequate policy, the concerns over one townhome or home being damaged and the home owner having no coverage would be minimized. If the association did not cover the building at all, and relied upon the owners to obtain adequate coverage, a loss to an uninsured home would be an "eyesore" to the entire association. By obtaining one master policy, the association has the greatest control over making sure adequate coverage is in force.

Disadvantages.

In foregoing their own HO-3 type policy and relying on an association to obtain and maintain adequate property insurance, individual owners trust someone else to insure what is most likely the most substantial investment they will ever make. The individual owners have no control over the master policy, have no way of knowing if coverage is adequate, don't know the terms and conditions of the policy, and have no realistic way of knowing if the policy lapses.

Lenders for the individual owners may not be willing to accept a single master policy, or may request (or demand) to be added as a mortgagee to the master policy. If numerous lenders were shown on the master policy, complications could result at the time of loss when the time comes to issue the claim check.

Also, in the event of damage to an individual unit, the claims check under the master policy will likely be paid to the named insured—the association. That leaves the individual owner relying on the association to disburse funds, something that could develop into a problem.

Individual Owner's Policy Still Needed.

If this "one master policy" approach is used, the individual owners still need their own homeowners policy, and the HO-4 type policy would be appropriate in such situations. It's important to remember that the HO-4 policy will not provide any building coverage, so if the master property policy is not in effect (or is inadequate) the HO-4 would be of no help to the individual owner.

Insurance coverage for **loss assessments** is not an issue unique to condominium unit owners. Many homeowners' association bylaws do permit assessing members of the association, thus it is important for individuals to carry higher limits of loss assessment coverage under their homeowners policies, even under the HO-4 policy. Both property and liability loss assessments are possible under many association bylaws. The HO 04 35 endorsement is available, at a very small premium charge, and should be recommended to all residents in any type of homeowners' or condominium association. An in-depth article on loss assessment is available by clicking [here](#).

Individual Policies Purchased By Owners

Overview.

Another option is for the association to purchase no master property policy, thus leaving the sole insurance responsibility up to the individual owners. In such case the individual owners would purchase their own policy, typically the HO-2, HO-3, HO-5, or HO-8 form. Company underwriting will dictate the availability of a homeowners policy, but, in general, many carriers will provide such policy for fee-simple homes, even if there are multiple units in a building. Under ISO rules, the use of the HO-2, HO-3, HO-5, or HO-8 is permitted with a "townhouse factor" for rating. The use of the HO-6 policy in such situation is technically not permitted under ISO rules and it also leaves the owners with a policy that is not appropriate for the risk.

Advantage.

The advantage of this approach for the individual owners is that they are in full control of their own insurance coverages, and don't have to rely on others (the association) to protect their sizeable investment. The homeowners policy should be written in an amount that is equal to the current replacement cost of the individual home.

Disadvantage.

One disadvantage of this approach is that if an owner in an association failed to purchase a policy, it could jeopardize the "curb appeal" of the association in the event of a major loss. For example, suppose that one of the ten owners in a townhouse complex failed to procure a

homeowners policy and that unit sustained a major fire loss. With no insurance in place, repairs may not be able to be made, leaving the other nine residents to live in a building which may best be described as an "eyesore." Such lack of insurance could also generate a significant loss assessment to the other owners if the association bylaws allowed for such.

Additional Insured Issues.

Often the association will request (or require) that the individual owners add the association as an additional insured on the homeowners policy. The HO 04 41 "Additional Insured endorsement is available for such situations. The endorsement provides premises liability coverage to the association under the homeowners policy, stipulates that any claims paid under Coverage A or Coverage B will include the association's name on a claim check, and provides the association with notice of cancellation or non-renewal. While the endorsement is well-suited for the situation, many (if not most) insurers refuse to add it to the homeowners policy. Such refusal may leave the individual between the proverbial "rock and a hard" place, with the inability to satisfy a homeowners' association board of directors. As an alternative to the Additional Insured Endorsement, the HO 04 10 "Additional Interest" Residence Premises endorsement is available. This endorsement provides only notice of cancellation or non-renewal to the party named and does not provide any coverage for the person or entity named. Yet another alternative to placate the association would be to issue a Certificate of Property Insurance under the individual owner's policy, showing the association as certificate holder. Like the HO 04 10, this method provides no coverage for the association.

Loss Assessment Coverage.

For the reasons cited earlier, loss assessment coverage should be increased under the homeowners policies.

Master Policy and Individual Policies:

Overview.

It's becoming more common for an association to have bylaws stating that the association will cover a portion of the building items and also mandating that individual owners will be responsible for certain building items. In such case, the potential for significant coverage problems is great unless care is taken to properly structure the policies.

A Possible Scenario.

For the sake of discussion, assume that the ten-unit building (or even the ten individual free-standing buildings) has a current replacement cost of \$200,000 per unit, for a total insured value of \$2 million. Further, assume that the homeowners' association bylaws dictate that the association is responsible for insuring a portion of the building items, totaling \$120,000 per unit, leaving \$80,000 per unit of building items to be insured by the individual owners. The bylaws state that items such as carpet, interior paint, wallpaper, appliances, cabinets, bath tubs, showers, interior doors, sliding glass doors, and interior non-load bearing walls are the insurance responsibility of the individual owners.

Master Policy.

In this "dual policy" concept, the association must purchase a master property policy, typically the CP 00 10, which was referenced earlier. As the policy comes "off the shelf," **all** building items are covered, even those which the bylaws state must be insured by the individual owners. If the value of those interior building items (\$80,000 per unit on ten units) is stripped out, that would leave \$1.2 million of building items which the association may feel should be the amount of coverage on the master policy. If the CP 00 10 is issued at the \$1.2 million of coverage, the association will face a coinsurance penalty at claim time, since the policy will not provide sufficient coverage under a typical 80 percent coinsurance clause. The fact that the bylaws indicate that the individual owners must insure the building items does not affect that

fact that these items **are still covered property** under the CP 00 10. In order to avoid such coinsurance problem, the master policy needs to be endorsed with the ISO CP 14 20 "Additional Property Not Covered endorsement. When this endorsement is attached, a description of the property not covered (paint, carpet, cabinets, etc.) must be listed in order to avoid the coinsurance problem.

Individual Owner's Policy.

From the perspective of the individual owners, this "dual policy" concept breeds the same potential for coverage gaps as the master policy. The owners must still purchase some type of policy, with the typical choices being the HO-3, HO-4, or HO-6 policies. (The HO-2, HO-5, and HO-8 are also options.) The HO-4 policy is clearly inadequate since no building coverage is included. The HO-6 policy might be an alternative, but technically under ISO rules, the risk would not qualify unless it is a condominium or cooperative unit. FAIA has polled various personal lines underwriters, asking "Would you write the HO-6 policy on a fee-simple townhouse or fee-simple stand alone house?" No affirmative answers were given by any underwriter; the reason stated being, "It's not a condominium unit, so it has to go on the HO-3." (In fact, one underwriting manager reported that his carrier was actually sued by a client when the company took the position that they would not provide the HO-6 policy on a fee-simple townhouse.) That leaves the HO-3 (or HO-2, HO-5, or HO-8) as the only viable alternative. Assuming that the HO-3 provided Coverage A in the amount of the \$80,000 in our example, the same underinsurance/coinsurance problem cited earlier remains at the time of loss. In order for the HO-3 policy to provide replacement cost loss settlement for building items, the amount of insurance must be at least 80 percent of the replacement cost of the entire structure. Failure to insure to at least 80 percent of value results in the policyholder being paid the actual cash value, or the amount that would be owed after applying any coinsurance penalty, whichever is greater. Unlike the commercial property program where an endorsement is available to remedy this situation, the homeowners program offers no such endorsement, leaving a possible shortfall come claim time.

Loss Assessment.

The same analysis applies as discussed earlier; increase the coverage.

Flood Insurance

Overview.

Many of the same issues concerning property insurance also apply for flood insurance. Of key importance, however, are the issues of limits of coverage available under the National Flood Insurance Program (NFIP) and the definition of a "single building."

Note that a homeowners' association is **not eligible** to purchase the Residential Condominium Building Association Policy (RCBAP). The RCBAP can **only** be written on a condominium association. This is a critical point, since the limits of coverage available under the RCBAP and the limits available under the dwelling form are dramatically different.

Limits Available.

The current limits of coverage available under NFIP for residential risks (such as is found in a homeowners' association) are \$250,000 for building coverage and \$100,000 for contents coverage. These maximum limits apply per building and have not changed in almost 20 years. Limits above the NFIP maximums are often available from private insurers and should be recommended by agency staff.

Under the RCBAP, the maximum available is \$250,000 multiplied by the number of units. For example, a 10-unit condominium building could purchase the RCBAP with a maximum building limit of \$2.5 million.

Single Building.

As stated, the maximum limits apply per building. NFIP defines a single building as follows:

B. Single Building

To qualify as a single building structure and be subject to the single building limits of coverage, a building must be separated from other buildings by intervening clear space or solid, vertical, loadbearing division walls.

A building separated into divisions by solid, vertical, load-bearing walls from its lowest level to its highest ceiling may have each division insured as a separate building. A solid load-bearing interior wall cannot have any openings and must not provide access from one building or room into another (partial walls). However, if access is available through a doorway or opening, then the structure must be insured as one building unless the building is self contained; it is a separately titled building contiguous to the ground; it has a separate legal description; and it is regarded as a separate property for other real estate purposes, meaning that it has most of its own utilities and may be deeded, conveyed, and taxed separately.

Following Hurricane Katrina, there were numerous errors and omissions lawsuits brought against insurance agencies involving flood insurance and the single building concept. In not understanding the single building definition, agencies wrote one \$250,000 policy on townhome complexes with multiple individual owners, as opposed to writing one policy per owner. In one specific case, there was a homeowners' association composed of eight buildings with eight separate units per building, each unit being separated by loadbearing, vertical, division walls. The agency wrote only eight policies, failing to realize that there were in fact 64 separate "single buildings" as defined by the NFIP manual.

Who Buys The Policy?

The NFIP Flood Insurance Manual is silent about the issue of whether the policy/policies are written in the name of the association or the individuals. The NFIP *Mandatory Purchase of Flood Insurance Guidelines* publication (September, 2007 edition date) states the following, starting on page 50:

4. Homeowners' Associations

Individually titled town homes and single family buildings, whose owners belong to a non-condominium homeowners' association, can be insured by the individual owners under the Dwelling Form and not by the homeowners' association. The homeowners' association may purchase coverage for a building it may own, such as a clubhouse, under the General Property Form.

Several individuals with positions of authority at FEMA have stated that a homeowners' association (HOA) can not buy a policy in their sole name unless the building is owned solely by the HOA. A clubhouse would be an example of such situation. Where units in an HOA are individually owned, the named insured must be the individual. The HOA can also be added "ATIMA" (As Their Interests May Appear) on the declarations page as a named insured.

One Write Your Own (WYO) flood carrier reported that after the 2005 storm season, there were many problems associated with situations where NFIP policies were written in the name of the association. Coverage was often found to be inadequate, and the single policy written for the association was "reformed" to provide coverage (albeit insufficient) for the individual owners. An example will illustrate:

The HOA is composed of six separate individually-owned units, each meeting the single building definition. Only one NFIP policy, in the amount of \$250,000 for

building coverage, is written and the named insured is the HOA. The replacement cost of the entire structure is \$1.8 million. A major flood loss takes place and the HOA opts for policy reformation. (If they don't, the policy is null and void.) The one policy is cancelled and six separate policies are issued, each with only approximately \$41,000 of building coverage. (\$250,000 divided by the six owners.) Each owner has 30-days to pay the premium notice for the limited coverage to apply. Of course coverage is inadequate, the policy will not provide replacement cost loss settlement coverage for the building (only ACV) and there will be no contents coverage available. Had this been written correctly, six policies at limits of \$250,000 building and \$100,000 contents would have been available. In effect, this example illustrates a \$1.25 million gap in coverage.

Preferred Risk Policy Eligibility.

Subject to normal eligibility guidelines (Such as the risk being in zone B, C, or X; no more than two prior losses, etc.) a townhouse or rowhouse qualifies for the PRP. Remember, the maximum building of \$250,000 applies per single building.

Summary

Providing property and flood insurance coverages for homeowners' associations can be challenging. It's imperative that a proper determination be made as to the legal organization of the association. Then a proper insurance package can be structured for both the association and the individual owners.

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