

## Lessons from Hurricane Andrew



By Gary A. Poliakoff

[gpoliakoff@becker-poliakoff.com](mailto:gpoliakoff@becker-poliakoff.com)

TEL (954) 985-4150

FAX (954) 985-4176

In the aftermath of Hurricane Andrew, the Boards of Directors and Managers of Community Associations throughout South Florida were confronted with a variety of issues dealing with insurance. For the most part, many were not familiar with the insurance provisions in their documents and the complex coverage issues created by the documents and applicable law. Indeed, many attorneys and insurance agents were in the same predicament. Consequently, we have chosen to tackle this many-faceted problem with the following broad overview of the issues that have arisen during this crisis and some lessons learned from it with respect to insurance.

Of greatest concern to most community associations is the scope of coverage. This issue has created much confusion among homeowners, and the confusion has only been made worse by the latest amendments to the Condominium Act (Chapter 718 Florida Statutes). As of July 1, 1992, the following revision to the Condominium Act became effective: Section 718.111(11)(b)

Every hazard policy which is issued to protect a condominium building shall provide that the word "building" wherever used in the policy include, but not necessarily be limited to, fixtures, installations, or additions comprising that part of the building within the unfinished interior surfaces of the perimeter walls, floors, and ceilings of the individual units initially installed, or replacements thereof of like kind or quality, in accordance with the original plans and specifications, or as they existed at the

time the unit was initially conveyed if the original plans and specifications are not available. However, unless prior to October 1, 1986, the association is required by the declaration to provide coverage therefor, the word "building" does not include unit floor coverings, wall coverings, or ceiling coverings and, as to contracts entered into after July 1, 1992 does not include the following equipment if it is located within a unit and the unit owner is required to repair or replace such equipment: electrical fixtures, appliances, air conditioner or heating equipment, water heaters, or built-in cabinets. With respect to the coverage provided for by this paragraph, the unit owners shall be considered additional insureds under the policy.

Quite simply, this revision appears to eliminate the Association's obligation to insure built-in-cabinets, electrical fixtures, appliances, air conditioner or heating equipment and water heaters, if the responsibility to repair and replace (i.e., when it breaks down or wears out) is the unit owner's. However, it is most important to note that this statutory provision only applies to: 1) Condominiums (not Homeowners Associations, Property Owners Associations, etc.) and 2) only to those insurance policies which were issued after July 1, 1992.

Furthermore, this change does not apply to all condominiums. Many condominiums are not bound by substantive amendments to the Act and need only comply with the substantive provisions of the Act, as it existed at the time the Declaration of Condominium was recorded. Moreover, many

Association documents require that the Association provide insurance coverage beyond that which is required by the Statute.

Consequently, many Associations may still be required to insure electrical fixtures, appliances, air conditioning, heating equipment, and water heaters, as well as ceiling, floor and wall coverings. Because most insurance policies contain broad language that provides that coverage will encompass that which is required by the documents, it is important that all Association representatives become familiar with the documentary provisions on insurance coverage. These provisions must also be reviewed by your agent so that there is a clear understanding of what the Association is responsible to cover.

The flip side of the insurance coverage issue is, of course, the policy itself. Many communities affected by the storm were surprised to learn that major sources of economic loss were **not** covered by standard insurance policies; namely, landscaping, exterior building paint, and building foundations; as well as up-upgrades required to comply with current codes. Furthermore, many associations may have gambled when setting policy limits and deductibles that the chances of suffering a total casualty loss within a community were slim to none.

In many cases, homeowners seeking to rebuild co-ownership interest communities will find that their policy limits are woefully inadequate to reconstruct the communities. The alternatives may be either to terminate the community or to levy a special assessment on already economically strapped owners, many of whom lost their sources of livelihood along with their homes. Some associations were fortunate enough to have obtained an addition to the standard policy, which provides coverage for assessments not collected as a result of the devastation.

The destruction caused by Hurricane Andrew revealed another deficiency in insurance coverage; namely, that many policies which covered the cost of replacement failed to contain “code enforcement endorsements,” necessary to cover building up-upgrades mandated by evolving building codes. Because the standard policy also does not cover the

cost of demolition, many communities attempting to rebuild will be faced with significant additional expenses, which are not covered by the policies.

Initial experience has shown that those who fared best are communities with an all risk (as opposed to named perils) replacement cost coverage, at an agreed amount. Although this may require an appraisal, this precludes the necessity of complying with any co-insurance provisions in the policy. In addition, Associations should consider obtaining such optional coverage as code enforcement and loss of assessment income coverage.

Of greatest surprise to many Associations has been the provision contained in many, if not most, sets of Association documents that require all insurance proceeds be disbursed to and held by an Insurance Trustee. What is an Insurance Trustee, what is the Trustee’s function? Is a Trustee necessary?

An Insurance Trustee is a creature of Condominium or Homeowner Documents. Hence, there is no statutory requirement for an Association to have one. However, many documents either require an Insurance Trustee or provide the Board of Directors with the option of designating one. Most documents which require an Insurance Trustee also define what type of institution may be an Insurance Trustee. Examples of this include: “...a national or state bank with trust powers” or “...a national or state bank with trust powers doing business in \_\_\_\_\_ County.” Some documents are so specific, they require a particular Bank or Trust Company.

It is important to note that the term “with trust powers” is a requirement that such Bank or Trust Company have the ability to place itself in the capacity of a Trustee (i.e., be a Trustee for the Association) under the applicable provisions of the Florida Banking laws. Very few banks in South Florida are qualified to be Trustees under current Florida Law. The majority can only create or open Trust Accounts with someone else as Trustee.

This seemingly technical distinction is quite important in this present era of government takeover of banks. In a situation in which a bank

holding an Association's Insurance proceeds in an ordinary Trust Account is taken over by the RTC or simply becomes insolvent, such account may only be insured for a maximum of \$100,000. However, in a situation in which a bank with trust powers held the Insurance proceeds as a Trustee, if the bank were taken over by the RTC, the monies would not be treated as bank assets and would thus be protected.

Another provision commonly found in many documents is one which requires the holder of a majority of the mortgages in the Community to approve the selection of the Insurance Trustee. Other documents simply allow the Board to select a trustee at its discretion. The former requirement can be quite burdensome since most Associations do not keep adequate records in this regard and because mortgages are quite routinely bought and sold on the secondary market. (Many unit owners have no idea who actually holds their mortgage).

The cost of obtaining an Insurance Trustee is varied and can range from 1/2 of 1 percent (.5%) of the return on the income generated from the fund (more precisely, 50 basis points) in the Trust (remember, the account is interest-bearing) to as high as 1 and 1/2 percent (1.5%) of the total amount of the insurance

proceeds held in trust. Because the difference can be in the tens of thousands of dollars, Associations must shop around before committing to any institution.

It is important, should your documents require you to have an Insurance Trustee, that you proceed immediately to obtain one before any insurance proceeds are disbursed. Every day that disbursement is delayed due to the lack of a Trustee, translates into money not earned in an interest-bearing account. If such proceeds are disbursed to the Association in violation of the Declaration of Condominium, the Board of Directors may be subject to a lawsuit by disgruntled unit owners for violation of their fiduciary responsibility.

Finally, all Associations should review the Directors and Officers Errors and Omissions policies (D & O policies) which the Association maintains. Most D & O policies provide that the policy does not cover claims against individual officers and directors alleging inadequate insurance coverage. Although it may be possible to obtain an endorsement eliminating this important exclusion, it is still extremely important for community associations to understand the requirements regarding insurance established by law and the association documents.

---

*Gary A. Poliakoff is the Managing Shareholder and heads the Community Association Practice of Becker & Poliakoff P.A. Mr. Poliakoff can be reached at 954-985-4150, or email [gpoliakoff@becker-poliakoff.com](mailto:gpoliakoff@becker-poliakoff.com)*