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CURRENT NEWS FOR COMMUNITY ASSOCIATIONS

CONDOMINIUM ASSOCIATION PROPERTY AND LIABILITY INSURANCE BASICS

Your association is finally operating to your satisfaction – all unit owners are content with their assigned parking spaces, the two-year-old roof is leak free, assessments are up to date and the Finkelsteins got rid of their 42 pound dog (40 pound limit means 40 pounds!). But, when was the last time your association reviewed the status of its insurance coverages? Adequate insurance coverage and other risk management strategies are among the most critical and fundamental issues that condominium associations and unit owners face. Virtually every association must grapple and routinely revisit issues regarding sufficiency of coverage, scope and extent of coverage, whether specific items are covered by the association's or unit owner's policy, and compliance with the Florida

Condominium Act (Florida Statute Chapter 718) and association governing documents. This article will highlight key factors and considerations that should be included in a condominium association's decision making process regarding obtaining appropriate insurance, and touch upon issues pertaining to unit coverage as well. Although this article focuses on condominiums, many of the concepts and issues are relevant to cooperative and homeowners associations.

Association's Obligation to Obtain Insurance

The association's obligation to obtain and maintain adequate insurance is governed by Section 718.111(11), Florida Statutes (the "Statute"). Additionally, the declaration of condominium likely augments the minimum statutory required coverages. The Statute begins by setting forth the standard under which condominium associations are to discharge their duty to obtain insurance coverage: "A unit owner-controlled association **shall use its best efforts** to obtain and maintain adequate insurance to protect the association, the association property, the common elements, and the condominium property required to be insured by the association." [emphasis added]. The somewhat vague and ambiguous terms, "best efforts" and "adequate," as used in the Statute raise interesting issues. Consider the following: (a) Under what circumstances will an association be deemed

continued on page 2

TIDBITS

Did You Know ???

Condominium and cooperative associations must prepare financial reports for the preceding fiscal year within ninety (90) days after the end of the fiscal year or annually on a date provided in the bylaws.

- ✓ Within twenty-one (21) days after the final financial report is completed by the association or received from a third party but not later than one hundred twenty (120) days after the end of the fiscal year or other date as provided in the bylaws, the association shall mail to each unit owner or hand deliver a copy of the financial report or a notice that a copy of the financial report will be mailed or hand delivered to the unit owner without charge, upon receipt of a written request from the owner.
- ✓ The financial report shall be based upon the association's total revenues as follows:
 - An association with total annual revenues of \$100,000.00 or more but less than \$200,000.00 shall prepare a compiled financial statement.

continued on page 2



BASICS...*continued from page 1*

to have employed its "best efforts" in satisfaction of this statutory mandate? (b) If coverage is not generally commercially available, to what lengths must an association go to procure coverage? (c) Is cost a factor? (d) At what point is coverage deemed "adequate?" The standard of care applicable to developer-controlled associations is (arguably) even greater, with the Statute requiring developer-controlled associations to "exercise due diligence to obtain and maintain such insurance," providing that failing to maintain adequate insurance "shall constitute a breach of fiduciary responsibility by the developer-appointed members of the board of directors of the association." s.718.111(11)(a), F.S.. [For further discussion of the board's fiduciary responsibility in this regard, please see the following decisions: *Munder v. Circle One Condominium, Inc.*, 596 So.2d 144 (4th DCA 1992) [Condominium developer breached fiduciary duty for failing to maintain fire insurance.]; *Perlow v. Goldberg*, 700 So2d 148 (3rd DCA 1997) (Unit owner-directors of a condominium were not personally liable for failure to properly administer insurance proceeds).

What Law Actually Governs?

The first step in considering appropriate insurance coverage is confirmation of what minimum coverage requirements apply to your condominium. This entails navigating through the Statute and your declaration. The Statute distinguishes between condominiums created before and after October 1, 1986, applying different coverage requirements to pre- and post October 1, 1986 condominiums. The Statute also distinguishes between insurance policies entered into prior and subsequent to July 1, 1992. However, it is safe to assume that policies in effect today were written subsequent to that date. Importantly, the Statute may not control the extent of and scope of coverage the association is required to maintain. It is necessary to review several sections of the declaration to establish what the association must insure and may insure, and what the unit owner should insure or whether the unit owner is obligated to purchase insurance at all. The pertinent sections of the declaration include the insurance provisions, as well as the provisions covering repair and maintenance. The

standard commercial condominium "bare walls" coverage may not be sufficient to comply with the declaration of condominium. In fact, the declaration of your condominium may require the association to purchase insurance coverage for wall, floor and ceiling coverings as well as original construction of unit interiors, including built-in cabinets and appliances. In a nutshell, ascertaining the governing insurance requirements should include consultation with legal counsel in addition to your insurance professional.

Adequate Coverage

We know that an association must obtain and maintain "adequate coverage," but what exactly is adequate coverage? Is adequate coverage sufficient to address the needs and concerns of the association? To appreciate "adequate coverage," it is important to be aware of a few basic insurance concepts. There are two primary components of insurance coverage relative to a condominium association: property insurance (sometimes referred to as casualty or hazard insurance) and liability insurance. Property insurance covers losses from perils such as fire, lightning, aircraft and vandalism. Coverage is limited to losses specifically provided for under the policy that are not otherwise excluded or subject to limitation. The payee is the insured. Liability insurance protects the association from claims made by third parties for losses such as personal injury and property damage.

It goes without saying that insurance on the building includes coverage for fixtures, installations and additions within the unfinished interior surfaces of the perimeter walls, floors and ceilings of the units. Is coverage for these items alone adequate? What else should be covered and what dollar value of insurance is adequate? "Adequate coverage" can be more easily understood by examining the following issues as well as the additional considerations appearing at the end of this article:

- Value of the real and personal property owned or maintained by the association;
- Cost to rebuild in as-is condition;
- Cost to rebuild in accordance with current building codes and standards;

TIDBITS**Did You Know ???***continued from page 1*

- An association with total annual revenues of at least \$200,000.00 but less than \$400,000.00 shall prepare reviewed financial statements.
- An association with total annual revenues of \$400,000.00 or more shall prepare audited financial statements.
- An association with total annual revenues of less than \$100,000.00 but which operates less than 50 units regardless of the association's annual revenues shall prepare a report of cash receipts and expenditures.
- ✓ If approved by a majority of the voting interests present at a properly called meeting of the association, the association may waive such financial reporting requirements in accordance with Section 718.111(13), Florida Statutes.
- Value of property and equipment maintained by the association;
- Determination of policy limits and deductibles;
- Understanding of association's unique/specific needs: (see below)
- Need for workers compensation/ employer's liability coverage

Although a unit owner is not required by statute to maintain insurance coverage, the failure to do so is foolish and may be detrimental to the association and other unit owners. The unit owners and association need to share the same understanding regarding where the association's coverage ends and the unit owner's begins. In short – who's insuring what? This question can only be answered by reviewing the applicable Statute and the insurance and repair/maintenance provisions of the declaration of condominium. While a unit owner will generally be responsible for insuring items located within the unit for which the unit owner has maintenance

BASICS...*continued from page 2*

responsibility, such as electrical fixtures, appliances, air conditioning, water heaters and built-in cabinets, that is not always the case. In condominiums created after October 1, 1986, unit owners are generally responsible for insuring floor, wall and ceiling coverings. The unit owner's policy is known as the HO-6 Form and includes coverage for the improvements as well as contents (wherever the insured's contents may be located). To maintain a reasonable level of insurance coverage, a unit owner must consider the following:

- Degree to which the association (assuming it is properly insured) will restore a damaged unit, appurtenances and limited common elements, and extent of coverage provided under association's policy;
- Expense to restore unit owner improvements;
- Value of personal property;

Additional Considerations

Deciding upon appropriate insurance coverages is a process which includes consultation with the association's attorney for clarification as to the governing statutory and declaration requirements, as well as discussion with a knowledgeable, experienced insurance agent. Consider the following in the course of your discussions:

- Obtain an appraisal of the building(s). This should not only include market value but replacement cost according to current building code.
- Prepare an inventory of all real and personal property for which the association has maintenance responsibility. The inventory should include buildings, detached structures, underground improvements such as sprinklers, pipes, cable and sewage lines, fences, pools, walkways, light poles, furniture, golf carts, computers, etc. These items should be valued and included in the appraisal. Importantly, the inventory should be routinely updated.
- Ordinance and Law Coverage. Although endorsements and

additional coverages are addressed below, Ordinance and Law Coverage merits its own discussion. Most policies include "replacement cost" coverage – full or a percentage of costs to replace damaged property to the state it was in immediately preceding the loss. However, new building codes will likely increase the cost to reconstruct. Consider changes in the building code which now require enhanced hurricane and fire protection, for example. These items would be excluded from coverage. Additionally, if code requires demolition of the entire building if damage exceeds 50%, demolition and reconstruction of the undamaged portion may be excluded. Ordinance and Law Coverage is an endorsement that would cover these added expenses.

- **Miscellaneous Endorsements and Additional Coverage.** Consider whether any of the following coverages would address a need of your association. **Boiler and Machine Coverage** (includes generators, engines and compressors); **Flood Insurance and coverage for water damage** (coverage for plumbing leaks, burst pipes, sewer backup, surface water, wind driven rain); **Electronic Data Processing Insurance** (covers association hardware and software); **Automobile/Non-Owned Automobile Insurance**; **Glass Coverage**; **Power Failure Coverage**; **Directors and Officers Liability Insurance** (protects the association and the officers and directors from the negligence and breaches by officers and directors of their fiduciary duty). Anyone intending to serve on the board of an association should ensure that this coverage is in place.
- Request a written explanation of policy coverages and exclusion from your agent. Ask your insurance agent to address the issues raised above, as well as whether and to what extent mold remediation and repair is covered, and whether demolition and smoke damage is covered.
- Review your declaration. Many declarations contain insurance provisions that may be outdated, overly broad or

otherwise not in the best interest of the association. For instance, some declarations require that an "insurance trustee" be appointed to handle and disburse insurance proceeds. Although lenders' consents may be required, these provisions should be replaced, naming the board as agent for the unit owners to manage insurance proceeds. Does your declaration include language requiring coverage on **all** developer improvements, or require the association to maintain an "all-risk" insurance policy? **All** developer improvements are far too broad and problematic, and there is no affordable policy that will cover "all risks." This type of language should be modified to avoid potential liability for failing to maintain coverage required by the declaration.

- Undertake periodic insurance audits to ensure that your coverage keeps pace with the changing real estate market, construction industry and technology.

Conclusion

Insurance planning is an essential element of your association's risk management program. Obtaining appropriate levels of insurance for your association is critically important. Inadequate coverage may result in assessments to unit owners for shortfalls in proceeds, and potential liability to the board. Moreover, as property and casualty insurance becomes less available in Florida, and with premiums escalating at unprecedented levels, associations have never been more challenged to locate "adequate coverage" with reasonable premiums and deductibles. The good news is that a well-conceived insurance program, procured with the advice of legal counsel and an experienced insurance professional, will help your association weather the storm.





CASENOTES

CASENOTES

Sitting on the Dock of the Bay

In *Shore Village Property Owners' Association, Inc. v. The State of Florida Department of Environmental Protection*, 27 FLW D1590 (4th DCA, 7/10/02), a 20-foot easement was granted down the center line between 11 lots that extended "to the waters of the Indian River." Initially, the lot owners built a dock, which fell into disrepair, was repaired and extended years later and then, again, fell into disrepair. When one of the lot owners tried to repair the dock, a lot owner adjacent to the Indian River filed a complaint with the Department of Environmental Protection and that agency stopped the work. The owners rebuilding the dock filed a lawsuit to declare their rights of access to the river and to rebuild the dock. The court held that, when an easement extends "to the waters," by implication, it includes riparian rights. Riparian rights are use rights necessary and incidental to access to and from the water. Once the court determined the easement included riparian rights, it further defined riparian rights to include the general use of the water adjacent to the property, to wharf out to navigability, and to have access to navigable waters. This, the court said, includes the building of a dock to have access to navigable waters. However, the right to build a dock is not unlimited and cannot increase the burden on the adjacent land more than reasonably necessary and contemplated at the time the easement was granted. Essentially, this means the height and length of the dock are subject to review, but not the right to construct a dock.

Define Your Terms

In the case of *Sorota v. Belmat*, 27 Fla. L Weekly, D1485 (4th DCA, June 6, 2002), the court interpreted the term "pro rata share" in a commercial lease, since the term was not otherwise defined.

In this case, the landlord owned a warehouse and office building and leased part of it to the tenant to be used as a grocery store. The lease provided that the tenant would pay for utilities on a pro rata basis if separate electric and water service meters were not installed. The meters were not installed, a dispute arose and the trial court held that the electric and water charges should be paid based on square footage. The landlord appealed, reasoning that the tenant was responsible for utility charges based on actual usage, not based on square footage.

The appellate court held that the term "pro rata share" was intended to mean that the tenant pay for those utilities it actually used. The tenant argued that meters were the only mechanism by which to account for pro rata charges. Absent meters, the next best approach to calculate damages was square footage.

The appellate court, however, determined that actual usage was subject to alternate determination, absent evidence to the contrary and, therefore, the trial court applied the wrong standard by implying square footage.

The lesson to be learned from this case is that any document using the term "pro rata" should specify the method of calculation.