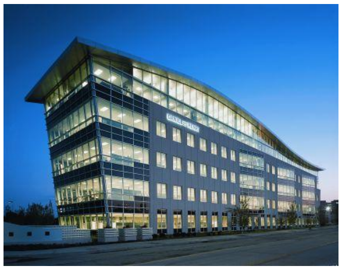

THE DANIEL AND HENRY CO.
INSURANCE AND RISK MANAGEMENT

Insurance Insights—Understanding Coinsurance

Coinsurance on Property Policies—What You Need to Know

For property managers, taking the time to understand association master insurance policies is well worth the effort. An insurance policy is a complex contract that often contains provisions that assigns certain responsibilities to the policyholder—one example being the coinsurance clause. Often misunderstood, this issue of *Insurance Insights* provides the community association manager the basics on coinsurance to help eliminate any potential confusion.

Coinsurance Explained

Did you know that an association may be penalized at the time of a claim if their property is under-valued?

In the simplest terms, the coinsurance provision in a property policy requires the policyholder to carry a limit of insurance equal to a specified percentage of the value of the property. If the value is not met, you may not receive full payment at the time of a loss. For example, a building with a value of $1,000,000 and a policy with an 80 percent coinsurance clause must be insured for at least $800,000 to avoid a coinsurance penalty at time of loss.

In short, the insurance company "allows" the association to under-insure their property, but only to the extent allowed by the coinsurance percentage. Remember—the value of the property is most often based on the replacement cost, not the market value!

Example of a Coinsurance Penalty

ABC Condominium Association has one building that the trustees have insured for $600,000 with 80% coinsurance. They suffer a major fire loss, causing $400,000 in damages. Unfortunately, the insurance values had not been updated in years, and the insurance company determines at the time of the claim that the actual value of the building is $1,000,000. This will result in a $100,000 coinsurance penalty for under-valuation at the time of loss! The table below provides the calculation for the penalty:

Building Insured Amount	Coinsurance Provision	Actual Building Value at Time of Loss	Allowable Insured Amount (80%)	Difference: Required Value vs. Actual	Coinsurance Penalty	Penalty Amount on $400,000 Loss
$600,000	80%	$1,000,000 Replacement Cost	$800,000 *($1,000,000 * 80% = $800,000)*	$200,000 Under Valued *($800,000 - $600,000 = $200,000)*	25% ($200,000 / $800,000 = 25%)	$100,000 ($400,000 * 25% = $100,000)

- **Common and Limited Common Elements** – Can include buildings, auxiliary structures, common area furniture, and all other real and tangible property defined by the Association's documents.

- **Machinery, Boilers & Other Building Equipment** – Some policies provide coverage for the breakdown of common equipment required for basic building operations, such as a central HVAC system.
- **Outdoor Property** – Can include signs, fences, landscaping and other outdoor assets.

If It's Not *All Risk*, You're At Risk

There are three types of property policies: *Basic, Broad* and *Special/All Risk*. As a rule of thumb, avoid basic and broad policies. These policies limit the perils (i.e., fire, lightning, etc.) covered by the policy. An "All Risk" policy insures against all perils except those that are specifically excluded. In short, it provides much better coverage.

Replacement Cost ≠ Market Value ≠ Actual Cash Value

Association trustees are often shocked that property limits are significantly higher than the current selling price of their buildings. However, the cost of rebuilding or repairing damaged property is significantly more expensive than purchasing a condo at market value. Many insurers use Marshall & Swift valuation software to calculate the property "Insurance to Value" (ITV), or replacement cost, of a property. The calculations factor in regional costs of construction materials and labor, which are updated quarterly.

Avoid Actual Cash Value! This is replacement cost value, minus a depreciation factor for age and condition of the property. We could write a separate paper on the issues with Actual Cash Value policies, but for brevity's sake, just avoid them at all costs!

Replacement Cost Per Square Foot Quick Reference – Midwest Region

The following table provides a very basic summary of acceptable replacement cost ranges per square foot. Many factors contribute to replacement cost, and a professional appraisal by a certified appraiser is the best way to determine the proper insurance valuation of an association's assets.

Cost Per Square Foot	Frame	Brick	Steel & Concrete
Single Family/Villas	\$85 – \$150+	\$100 – \$150+	\$125 – \$175+
Low-Rise (< 3 Stories)	\$100 – \$150+	\$125 – \$175+	\$125 – \$200+
Mid-Rise (3-6 Stories)	\$125 – \$150+	\$125 – \$200+	\$150 – \$225+
High-Rise (6+ Stories)	N/A	\$150 – \$250+	\$175 – \$300+

The Coinsurance Provision & Penalties

In the simplest terms, the coinsurance provision in a property policy requires the association to carry a limit of insurance equal to a specified percentage of a property's value. For example, if the replacement cost of a property is \$1,000,000 with an 80% coinsurance provision, the association is only required to insure the building for \$800,000.

But what if the association only insured the building for $600,000, or 75% of the required $800,000 value? In this case, the insurance company will apply a 75% factor—the coinsurance penalty—to any loss payment. So, a $100,000 loss will only result in a $75,000 payment ($100,000 x 0.75). Coinsurance penalties show why proper building valuation is important. Imagine Unit Owners' reactions to a special assessment to pay for a coinsurance penalty! It's best to avoid coinsurance altogether—ask for Agreed Amount or no coinsurance, if possible, to remove the coinsurance penalty.

Summary: Basic Requirements of Property Policy

Not all property policies are created equal! Many trustees only look at cost without considering coverage. An unpaid or underpaid claim may require a large special assessment (not to mention the ire of Unit Owners). When reviewing your clients' policies, always check for the following:

- **Policy Covers Association's Insurable Assets, as Required by Association Documents**
- **"All Risk" Policy**
- **Adequate Property Limits / Insured-to-Value Ratio**
- **Avoid Coinsurance Penalties**
- **Exclusions Are Outlined Clearly**
- **Agent Has Experience with Community Associations**

If you or your clients have any questions regarding property coverage, or any other insurance-related matter, The Daniel & Henry Company team is always willing to help. Call us today at 314-444-1993.