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LIVING HIGH IN THE SKY – TRENDS IN CONDO INSURANCE

Introduction

Condos are changing city skylines and streetscapes across the country. The recently released National Household Survey 2011[1] reveals that one in eight households lived in condos.[2] Condo insurance is not a new product, but recent news stories make it clear that condo dwellers don't understand some of the unique claims they may face and what they should consider when seeking condo insurance. As well, there a few trends in condominium insurance that have caught unwary condo owners by surprise.

"We do hear of cases where condo owners receive unfortunate surprises when they make a claim. This surprise stems, in part, from a misunderstanding between their specific policy coverage versus what the condo corporation's policy coverage actually provides and also from not realizing the unique exposures condos face," says Paul Johnstone, Senior Vice President, Chubb Insurance Company of Canada. "To fully understand the exposure level, it is important that a condo owner review their condo insurance with their insurance broker," says Johnstone.

Indeed, a recent survey by Allstate Insurance Company of Canada and Abacus Data show that 61% of condo owners they surveyed aren't clear on what the condo corporation's insurance covers, especially in the event that the condo owner's actions cause damage.[3]

About this Paper

This paper is not intended to provide a comprehensive discussion of issues related to insuring the interests of condominium owners or condominium corporations. Instead, it focuses on the ways in which condo unit owners are potentially at risk of being under-insured and some of the insurance trends that are emerging as condominiums become the residence of choice of more-and-more Canadians.

To keep things simple, for purposes of this paper, references to "condo owners", include condo dwellers regardless of whether they own or rent the unit. Similarly, reference to "condo insurance" is insurance on an individual condo (or strata) unit. Condo corporation insurance is insurance taken out by the condominium corporation.

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[1] The survey, which involved about 4.5 million households across Canada was conducted by Statistics Canada in 2011 and published in the fall of 2013 by the Ministry of Industry.
[2] Included in this number are people who live in owner-occupied condos as well as people who rent. According to the survey, rented condos represented about one in four condos.
[3] http://www.allstate.ca/Allstate/about/newsroom/newsroom.aspx?article=gta-condo
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Scenarios for Discussion

To try to understand how condo owners might be in for an unpleasant surprise when they end up out-of-pocket because they didn't understand the nature of their coverage, we're going to consider two scenarios. Scenario 1 is a situation where a unit owner's action causes damage to their unit, to the condo common elements, and to an adjoining unit. Scenario 2 is a situation where the condo building suffers major damage that impacts multiple unit owners. Both scenarios highlight the unique interplay between the unit owner's insurance coverage and the condo corporation's coverage.

- **Scenario 1 Introduction – Unit Owner's Goof**

  Mr. Gotta-Run owns a unit in a multi-story condo building. He has lived there five years and is the second resident of that unit. One morning, just before he leaves for work, he starts the dishwasher. When he comes home that night he finds huge fans outside his unit and notices the carpet in front of his door is soggy. When he opens his front door he sees his front hall hardwood flooring is warped from water and there are puddles near the base of the broken dishwasher. He then sees a note on the counter from the property management company saying they had entered the unit and shut the water off to his unit, but not until his neighbor downstairs heard dripping. Mr. Gotta-Run contacted his broker to tell the broker what happened and to get help determining whether it made sense for him to make a claim against his all risks policy.

  The property manager's action helped limit the damage. But, renting the dryers, repairing and repainting the ceiling and wall in the unit below Mr. Gotta-Run's unit, and cleaning the hall carpeting cost $1,600. As for the damage to his unit, replacing the hardwood in the hall and the baseboard in the hall and kitchen cost $1,400. Mr. Gotta-Run has a $1,000 deductible and he does not have Loss Assessment coverage.

- **Scenario 2 Introduction – Severe Damage to Condo Building**

  Mr. and Mrs. Retiree own a unit in a loft-style condo in a converted factory in a warehouse district. Mr. and Mrs. Retiree have an all risks policy. A fire in a nearby vacant warehouse spreads to Mr. and Mrs. Retiree's building causing extensive damage to the building's electrical and mechanical systems while Mr. and Mrs. Retiree were away on a three-week visit to their son. After the fire was put out, the city fire marshall determined it was unsafe for residents to return until repairs were made. The city's emergency assistance team put the residents up in hotels for the first few nights, but they were told to contact their insurers.

  Two weeks after the fire the property manager notified unit owners that it would likely be 10 months before the building would be habitable again. Mr. and Mrs. Retiree learned about this on their return. They phoned their broker immediately and then bought the local paper to start looking for an apartment. They were surprised by the fact that there were not many listings for furnished rentals and they started at $2,400/month plus utilities.

Before analyzing these scenarios, we'll review some basic features of condo living and condo insurance and then we'll discuss the insurance issues relevant to Mr. Gotta-Run and Mr. and Mrs. Retiree's situations.

Some General Concepts

In the simplest terms, condominiums are developments that feature individual ownership of units (or strata units in some provinces) and group ownership of common property, such as the lobby, elevators, recreational facilities, parking garage infrastructure, and so on, through a condominium corporation. Condo corporations are governed by a board of directors comprised of unit owners. Most condo boards contract out day-to-day running of the corporation to a property management company.

Unit owners pay for the condo corporation's costs through maintenance fees. Generally speaking, condominium corporations are required to carry insurance on the common elements and such policies are basically commercial property and casualty policies. Individual unit owners can also take out personal insurance to cover specified losses they incur as a result of owning the unit, as well as liability coverage in the event they are sued for damage they cause.

Assessing Whether a Condo Owner has Sufficient Coverage
Determining whether a condo owner has sufficient coverage involves understanding various distinct insurance issues:

- the type of coverage available a unit owner,
- the unit owner's particular needs, and
- the condo corporation's coverage.

Basic Condo Coverage
The key types of property coverage condo owners should look for are described in this section:

- Personal Property
- Additional Living Expenses
- Improvement and Betterment Protection
- Loss Assessment Protection
- Unit Additional Protection

Note that liability coverage and the wide variety of endorsements available to condo owners are not discussed in this paper.

Coverage for Contents (Personal Property)
The insured must determine the value of his or her personal property and must know whether the insurer will pay based on the replacement cost or the cost less depreciation. As well, the insured must be aware of whether there are any sub-limits with respect to particular items and must understand how they work. For example, if the policy limits claims for bikes to $1,000 per bike and the insured's $5,000 Cervelo bike is stolen, the insurer will only pay out $1,000 (or less if there's a deductible). Another example is a sub-limit on works of art and antiques that is limited to the lower of a specific percentage of the total coverage for personal property and a per item amount. It's not unusual for the specified percentage to be quite a lot less than the per item amount.

Additional Living Expenses
In the event a unit is unfit for occupancy and the owner must move out while it is being repaired, if the unit owner's insurance coverage includes additional living expenses, costs like rent and utilities the owner incurs while the unit is being repaired are covered. The extent of the coverage for additional living expenses varies widely. Often the coverage is a fixed percent of the personal property coverage, though some policies, such as Chubb's Masterpiece policies, provide unlimited additional living expenses.

"Limits related to additional living expenses are definitely something people should pay attention to, especially in areas where rents are high and vacancy rates are low. In such markets you may find it difficult to find accommodations and what little is available may be very expensive. So, a person should calculate approximately how many months of additional living expenses they're covered for, based on a realistic estimate of the current cost of renting in the area they would want to live, should something happen and they have to temporarily move out," advises Jim MacKenzie, FCIP (Hons) of Dusyk & Barlow Insurance Brokers Ltd.

Coverage for Unit Improvement and Betterment
This coverage provides for replacement of improvements the insured made to things like kitchen cabinetry, flooring, and fixtures. Many condo owners fail to realize that, in the event the loss is covered by the condo corporation's insurance, such

coverage will normally cover costs only related to bringing the unit back up to the standard unit. So, if they have made changes and improvements, they should make sure they have coverage for it.

"The number one misunderstanding condo owners have relates to not knowing or understanding how the standard unit is defined in their case," says Johnstone. The standard unit is defined either by reference to the condo corporation's declaration, by-laws, or governing provincial law. Under Ontario's Condominium Corporations' Act ("the Ontario Act"), for example, a condo corporation can adopt a by-law defining what a standard unit is. If, however, the corporation does not enact a specific by-law, the Ontario Act[4] says that the standard unit as defined in the declaration applies.

The trend these days is that condo corporations are adopting by-laws that define a standard unit as a pretty bare-bones shell. For example, a standard unit may only include things like all pipes, wires, cables, conduits, ducts and mechanical apparatus (such as the heating and air-conditioning installations), or it may go beyond that and include some finishes, such as basic carpeting, closet shelving, and cabinets installed by the builder in kitchens and bathrooms. Any betterments or improvements in the quality of any finishes beyond basic finishes (for example, tile or wood flooring, granite or other custom counters, blinds, lighting fixtures, and so on) typically are not included in the definition of a standard unit.

There are a number of reasons condo corporations are moving toward adopting a standard unit by-law, says Mark Shedden, FCIP, President and CEO of Atrens-Counsel Insurance Brokers, Inc. "First, betterments that were made part of the unit prior to registration may be considered the responsibility of the corporation to insure. In this case unit owners would technically be paying for the betterments of other owners under the corporation policy. This presents an issue of inequality of coverage provided by the corporation. Second, buildings are aging and it is hard to establish what was original to the unit and to determine the value of what would have been in the unit. Passing the by-law provides clarity to existing owners and future buyers. By knowing what is in the standard unit, a unit owner can better determine the value of their betterments and improvements," says Shedden. "Finally, passing a standard unit by-law (SUB) gives the corporation an opportunity to better manage the policy of the corporation. For example, by removing floor coverings out of the Standard Unit Definition, the corporation can limit nuisance type claims that contribute to loss costs from flooring claims that would better be covered as a betterment under a unit owner's policy. Keeping the units liveable and sellable, from a corporation insurance perspective, despite a unit owner having coverage, is key to protecting the interest of lenders who also have an insurable interest in the unit. Never pass a SUB that strips the units bare, however", advises Shedden.

Loss Assessment Coverage

This coverage protects a unit owner if the owner becomes subject to an assessment levied by the condo corporation. This could occur if the corporation issues a special assessment to all owners to cover a loss to the condominium common areas or if the corporation issues an assessment to the individual owner as a result of a loss the owner caused that the condo corporation covered.

Coverage for special assessments is important because they are becoming more common in some areas. A blog posting on Alberta insurance broker Lane's website, posted September 20, 2013, offered this rationale for the increase in special assessments condo owners are facing: "Unfortunately, special assessments are becoming more and more common in Calgary and throughout Alberta. By and large, this is the result of the condo boom that swept across the province beginning in the 1980s and 1990s, and continuing into the 2000s and the current decade. To meet market demands, property developers and construction companies fast-tracked a large number of condominium projects, and the unintentional end result has been that some buildings just aren't standing up to the elements as well as they were originally intended. … Repairing building damage

[4] See Subsection 89(4) of the Ontario Condominium Act, 1998, S.O. 1998, Chapter 19.

can cost a great deal of money; one 240-unit building in north Edmonton required $6 million in repairs despite the fact that it was just seven years old. That's an average of $25,000 per unit…”.[5]

As noted, Loss Assessment coverage typically also includes coverage, usually up to a sub-limit, for an assessment a condo owner could face for the cost of repairs the condo corporation makes, or the amount of the deductible the corporation paid under its policy as result of a loss caused by the condo owner. While this coverage, sometimes colloquially referred to as “chargeback of deductible”, is helpful, condo owners still face a risk if the condo corporation’s deductible is higher than what their individual policy covers for such assessments. Indeed, one of the alarming trends is that some condo corporations are opting for very high deductibles, particularly in British Columbia. A CBC British Colombia story from September 2012 reported that 19 condo towers in downtown Vancouver had policies with $50,000 deductibles and six with deductibles of $100,000.[6]

With typical Loss Assessment policies only protecting against condo corporation deductibles up to $25,000, many condo owners are facing a lot of potential risk. Jonathan Smith CIP, Senior Regional Underwriting Manager at Aviva notes that when it comes to sub-limits on such Loss Assessment coverage, not all companies will offer buy-ups for additional coverage. So, if a unit owner knows that the condo corporation’s deductible exceeds the sub-limit available on the unit owner’s policy, the unit owner may want to find a different insurer..

“Every condo corporation’s policy is different. Some policies have deductibles as low as $1,000-$5,000, but it’s up to the condo unit owner to check the corporation’s insurance certificate every year to know what the corporation’s deductible is,” advises Shedden.

Unit Additional Protection

This coverage responds if the unit owner suffers a loss and the condo corporation doesn’t have insurance, or if the corporation’s insurance is inadequate or not effective. While there haven’t been many reports of situations where this coverage has come into play, if the trend of condo corporations looking to ways to reduce their insurance costs continues, it is conceivable that a building could suffer a loss that would severely damage so many units and infrastructure that the corporation’s insurance might end up being inadequate.

Scenario Analysis

Scenario 1 – Mr. Gotta-Run’s Dishwasher Mishap

Mr. Gotta-Run’s broker explained that damage to his unit would be covered under his policy, subject to the $1,000 deductible. She also mentioned that he would likely be on the hook for any damage to the hallway and the unit below him. He was surprised, as the assumed the condo corporation’s policy would cover that. After hearing this, he spoke with the property manager who confirmed that the condo corporation would charge him for the lesser of the cost of the repairs and the corporation’s deductible. Though Mr. Gotta-Run had lived in the building for a long time, he had never been to an annual general meeting and he never even noticed the Certificate of Insurance that was included in the AGM package. The property manager assured him that the corporation’s deductible was “only $5,000”, so that would be the most he would be expected to pay.

When all was said and done, Mr. Gotta-Run had to pay $1,600 to the corporation for the repairs to the other unit and the hallway because he does not have Loss Assessment coverage. But, his insurance did cover $400 of the cost of repairing his unit ($1,400 less the $1,000 deductible).

[5] http://blog.lanesinsurance.com/blog/bid/316439/Condominium-Insurance-in-Calgary-Essential-for-Homeowners
[6] http://www.cbc.ca/news/canada/british-columbia/b-c-condo-owners-on-the-hook-for-huge-deductibles-1.1297521

Though Mr. Gotta-Run probably isn't too thrilled about being out of pocket $2,600 for this little mishap, things could have been much more costly. If, for example, in addition to the repairs to the walls and ceiling, his downstairs neighbor's hardwood floors had all warped and needed to be replace to the tune of $8,000, the condo corporation would only pay for repairs up to the standard unit finishes. Assuming the corporation had a standard unit bylaw that defined the standard unit as not including any flooring, the neighbor would likely make a claim on his or her policy for the cost of the betterments. In that case, the neighbor's insurer would likely bring a liability action against Mr. Gotta-Run for the cost of the hardwood.

Scenario 2 – Fire Forces Mr. & Mrs. Retiree Out for Months
Given the severe nature of the damage cause to Mr. & Mrs. Retiree's unit and the entire building, they will be making a claim for the replacement cost of their personal property as well as for betterments and additional living expenses. Depending on the condo corporation's coverage, they might even have to make a claim for Unit Additional Protection.

In terms of their coverage, Mr. & Mrs. Retiree have a single limit policy with personal property coverage of $75,000, Improvements and Betterments are covered up to $75,000, Additional Living Expenses of $30,000, Unit Additional Protection of $180,000, and Property Loss Assessment of $180,000.

In making their personal property claim, Mr. & Mrs. Retiree will have the usual burden of demonstrating what they had. Hopefully they have documentation and photos of their contents, and hopefully that information was stored someplace safe from the fire. The condo insurance will cover finishings up to the standard unit and then Mr. & Mrs. Retiree's policy will cover betterments.

If they rent an apartment for $2,400 and pay an additional $150/month for utilities, their $30,000 of Additional Living Expenses will only cover them for just over 11 months. Though the property manager estimates it may take 10 months for the work to be done, if that timetable is optimistic, Mr. & Mrs. Retiree may run short. One other issue that they may be concerned about if they read their policy is the possibility that their Additional Living Expenses might be limited in duration (for example, if the insurer considers this to be a situation where a civil authority has prohibited access to the building or the unit). Such a provision is generally meant to apply in mass emergency situations, not to cases where a fire marshall considers a building unsafe.

We don't have enough facts regarding the extent of the damage to the building or about the extent of the condo corporation's insurance, but Mr. & Mrs. Retiree should be made aware of the potential concerns and how their coverage for Unit Additional Protection might apply.

A Few Other Matters
And finally, a brief discussion of a few other points that often come up in relation to condo insurance.

Living in a Condo Before the Building is Registered
It's not unusual for a condo owner to move into a newly built condominium before the building is registered. Until the condo is registered, occupants are not owners, but are more in the nature of being quasi tenants. Such occupancy is generally referred to as "interim occupancy", according to Stephen Karr, a partner at the law firm of Harris, Sheaffer LLP, a Toronto based boutique firm specializing in condominium development. In such cases, Karr says the unit owner should ask his or her insurance broker

for a condominium homeowners package for contents and general liability and advise their broker that they are in the "interim occupancy period".

After the condominium corporation is officially registered, there will be a "final closing" (usually 20-40 days after registration, according to Karr), at which time title to the condo unit will be transferred to the unit owner. At this point, the unit owner should contact his or her insurance broker and tell the broker they are now the registered owner of the unit.

Once the condominium building is registered, the owner should obtain a copy of the condominium corporation's certificate of insurance (typically provided as part of the status certificate) and give their insurance provider a copy. The owner should also find out the details of the newly registered condo corporation's insurance coverage, what the relevant deductibles are, and how the standard unit is defined. As well, on a going-forward basis, the owner should pay attention to whether, as a result of a by-law adopted by unit owners, the definition of a standard unit is changed. Owners should also be aware of the fact that sometimes, after any builders' warranties or other warranties that may have applied have expired, based on their claims history and insurance costs, condo boards may look for ways of keeping the condo corporation's insurance costs down, so they may increase deductibles or propose changes to the by-laws that shift more of the insurance risk to unit owners.

Should the Condo Unit Owner Seek Coverage from the Same Insurer as the Corporation?
Given that in some cases both the condo corporation's insurance and the condo owner's insurance may respond to the same loss, there is an argument that it makes sense for a condo owner to seek coverage from the carrier the condo corporation uses. Insurance professionals differ in terms of how they respond to this argument. "From a claims settlement perspective, the paperwork and coordination is certainly easier if the same corporation and unit owner's policies are both written by the same company," notes Shedden. But, from risk spreading perspective, as Johnstone points out, "There could be aggregation issues if the same company did the corporation and every unit owner. After all, that would be a lot of exposure."

"Insureds should consider whether the condo corporation's insurer is the best fit for their own unit owner needs as well when choosing the market for their unit owner policy. For example, if the condo corporation's insurer limits bicycles on unit owner policies to $1,000 and the unit owner has a $5,000 bike, a second insurer with a higher bicycle limit might be preferable, regardless of the slight inconvenience that might be faced as the insurers coordinate in the event of a claim," says MacKenzie.

How Do You Find Out About the Condo Corporation's Insurance?
The short answer to how you find out about a condo corporation's coverage is you ask the board. Of course, the longer answer depends on whether you're already an owner, or whether you're a potential owner. When buying a condo, a purchaser's lawyer will review the condo's status certificate. (Condo corporations often charge a small fee for providing a status certificate.) Information about the condo corporation's insurance is always included in the status certificate.

Unit owners can find out about the condo corporation's insurance by asking the board or the property manager for a copy of the Certificate of Insurance. As well, information about the corporation's coverage is normally included in the AGM package.

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