

9.6.2025

UNDERSTANDING HOMEOWNER ASSOCIATION INSURANCE

FILED UNDER

[Maintenance & Insurance](#)

POSTED

December 23, 2020

SHARE

MASTER POLICY

Master policies are a form of property and liability insurance carried by associations that the members pay for as part of their assessments. Master policies typically cover common elements in a community as well as portions of units at times. State laws pertaining to condominiums and most project legal documents creating condominiums require condominium associations to carry master insurance policies covering the entire project including the individual units.

In planned unit developments, such as single family and townhome communities, the advisability of having a master policy depends to some extent on the type of construction. With attached townhouses or row houses, it is possible that a master policy is preferable to individual policies covering each dwelling. A master policy may cost less money than a collection of individual policies; it is also easier to ensure adequate coverage for the entire project with a master policy than it is with individual insurance policies issued by different companies.

Usually the developer of a project will have purchased an insurance policy that will be in effect at the time the board of directors is taken over by the new owners. The project legal documents will normally specify whether the insurance policy must be a master policy covering all improvements in the project, or whether the policy is only required to insure common elements and leaves it to individual owners to insure their own property.

No doubt, the most efficient way to handle insurance in either a condominium or a planned unit development project is to have a single master policy covering all of the units/lots and to have each separate unit/lot owner carry only liability insurance and personal property insurance covering the contents of their unit dwelling or office, as well as payment of the master policy deductible amount. This will eliminate conflicts among carriers because of overlapping coverage, will save overall premiums, and should eliminate gaps in coverage as well as duplication in coverage.

INDIVIDUAL POLICIES

Individual owners may obtain a special homeowner policy covering the contents of their units and insuring them against personal liability for incidents inside their units. This policy is called an "HO-6" policy, and will cover loss or injury within a unit, but will exclude liability for actions occurring in the common elements or damage to the common elements.

Owners can obtain additional endorsements to the HO-6 policy, including an "all risk endorsement," an endorsement for payment of the master policy deductible amount, a living expense endorsement, a rental coverage endorsement (if he/she has rented his/her unit out and loses rent as a result of fire or other damage), and a loss assessment coverage (covering special assessments levied because of uninsured losses to common areas).

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In communities where individual policies are required instead of master policies, such associations' legal documents typically set minimum insurance standards to be met by each owner. Procedures should exist to ensure application of insurance proceeds to repair of the property. Some master policies exclude rain damage to the interior of the building unless the rain entered through a hole made by the wind, allow for depreciation to be deducted on any loss to carpets and built-in appliances, and limit coverage on glass breakage to so much per pane with a maximum per occurrence unless the loss is caused by fire, wind or hail.

Therefore, the individual owner must protect with his/her own insurance by obtaining a rider to cover: personal property, including furniture and clothing; fixtures (depending upon whether the master policy covers fixtures); glass breakage (depending upon master policy coverage); additional living expenses; loss of rental income (if unit is rented); personal liability; loss assessment (coverage for payment of special assessments occasioned by inadequate insurance coverage for loss to common areas); and the amount of the master policy deductible.

CASUALTY INSURANCE

"Casualty" insurance is a broad term used to describe property insurance. It is sometimes called "all risk" or "comprehensive" insurance.

LIABILITY INSURANCE

Liability insurance protects associations against claims based on bodily injury or property damage for which the association may be legally liable and which are caused by an occurrence covered by the insurance policy. Although liability or "Commercial General Liability" (as it is most often called) covers many areas, there are also certain types of incidents excluded from liability coverage. Some of these include injuries from automobiles, boats or aircraft; injury to employees arising out of employment; injuries arising from discharge of smoke, fumes or chemicals; damages for false arrest, malicious prosecution, wrongful entry, eviction, libel or slander; contractual liability, host liquor liability; and non-owner automobiles. Most, if not all, of these exceptions can be covered under separate endorsements.

The best way of protecting associations and individual members of an association from unlimited tort liability is through a comprehensive insurance program including adequate public liability insurance. .

COMPREHENSIVE OR ALL-RISK COVERAGE

Comprehensive or all-risk coverage is also referred to as "extended coverage" or "special form coverage." "All risk" usually means that you are insured for "all forms of physical loss" except for specific exclusions which are mentioned in the policy. Fire, theft, and vandalism are normally included in an all-risk or comprehensive policy.

FLOOD INSURANCE

Flood insurance may or may not be available, depending upon where the project is located. In designated flood hazard areas, flood insurance may be required by lenders or by secondary lending agencies, such as FNMA or FHLMC. If the project is located in a designated flood hazard area, the individual policies which the owners carry on their contents should include flood damage, and the association should obtain flood insurance through its agent.

WORKERS' COMPENSATION

If an association has employees, it is required to carry workers' compensation insurance. The amount of the premium is generally determined by the total employee payroll. Generally, non-compensated volunteers of nonprofit organizations are not considered employees for purposes of workers' compensation unless the board of directors has specifically

declared prior to any injury occurring that the people performing such voluntary services are deemed to be employees while performing such services. An association might wish to do that in order to provide some insurance coverage for injuries of members serving voluntarily without pay, and verify this coverage with its insurance carrier.

Examples of employees for which the association would be required to carry workers' compensation insurance if they are on the association payroll would be maintenance personnel, on-site or resident managers, guards and gardeners. In some states, laws require that workers' compensation be carried for workmen or contractors who work on the premises even though they are not employees of the association.

Under Colorado law, the definition of the employer/employee relationship has been broadened statutorily to include subcontracted work which is part of the regular business operation of the employer. (CRS 8-41-401). Therefore, an association which regularly contracts for a service, such as landscaping, may be considered an employer of the persons associated with the landscaping maintenance. The liability for injury travels "up the chain" from the injured person, to the subcontractor, to the association.

If a contractor or subcontractor fails to carry adequate worker's compensation coverage for its laborers, an association may incur liability from two sources: first, claims due to injury or death; and second, premiums. If a claim due to injury or death occurs and the subcontractor for whom the injured party works fails to carry worker's compensation insurance, the association may be liable for 1½ times the amount of the claim. Additionally, if the claim triggers an audit, or if a routine audit occurs and the subcontractor failed to carry adequate coverage, the association may be charged a premium for the period of time that the subcontractor failed to carry adequate coverage.

AUTOMOBILE INSURANCE

In the event the association owns any vehicles, it should carry adequate automobile insurance, including personal injury, liability and property damage, medical and comprehensive including fire, theft and vandalism on the vehicle.

NON-OWNED AUTOMOBILES

If the association does not own an automobile and does not have automobile coverage but has a basic public liability policy, that policy may exclude from coverage the damages or liability arising out of the use of non-owned automobiles. The association should obtain an endorsement to its liability policy that will include non-owned automobile insurance coverage. This will cover the association or an officer, director, or agent of the association should he/she be using his or her own automobile on association business when a loss occurs.

DIRECTORS' AND OFFICERS' LIABILITY INSURANCE

Officers and directors of an association may be named in lawsuits brought by owners and third parties. Associations should obtain adequate insurance protection to cover its directors, officers, volunteers, and other agents. The insurance may not cover liability for intentional acts or liability arising from civil rights violations or liability resulting from failure to purchase adequate insurance for the project. However, it is necessary to have such coverage if the association expects to have its members serve in positions that may subject them to getting sued.

Some officers' and directors' liability policies are issued on a "claims made" basis, which means that they offer protection only for claims made during the policy period based upon acts occurring while the policy was in effect. Other policies may protect against claims arising during the policy period regardless of when the act occurred. Some policies will not cover officers and directors for liability from claims arising from actions taken while they were on the board when the claims are made after they are no longer on the board. The association should shop around and try to get the broadest coverage possible, and should be sure to inform officers and directors exactly what the extent of the coverage is. Of course, the association should indemnify its officers and directors against personal liability that is not covered under the association's policy.

RAIN DAMAGE

Most blanket insurance policies exclude rain damage to the interior of units unless rain enters through a hole made by the wind. Even if the rain is forced in by the wind, there may not be coverage unless the building sustained actual damage first. A homeowner can obtain rain damage coverage by asking that his/her standard unit owners' policy (HO-6) be broadened to include rain damage. Rain damage coverage is normally included in the standard HO-32 rider. The coverage under policies, of course, varies greatly, and it is important that the unit owner determine exactly what coverage there is under the master policy and what coverage can be obtained under his/her unit policy by additional riders. This is to eliminate the gaps in coverage so that no matter how or where the loss or damage occurs, it is covered by some policy.

AUXILIARY STRUCTURES

Auxiliary structures such as fences, signs, pools, carports, etc., may not be covered under a standard comprehensive or all risk casualty policy unless they are specified. The board should be sure that auxiliary structures are covered, and that, if necessary, their values are included in computing the total amount of insurance to be carried.

GLASS COVERAGE

It may be necessary to add glass coverage or "plate glass coverage" as an additional rider to an insurance policy in order to get full coverage.

DRAM SHOP/LIQUOR LIABILITY COVERAGE

If the association operates a bar or at any time dispenses alcoholic beverages, it is essential that the association get a dram shop coverage rider to its liability policy.

ASSOCIATION'S PERSONAL PROPERTY

If the association owns personal property, such as clubhouse furniture, pool furniture, or exercise equipment, that personal property should be insured to full actual cash or replacement value under the association's master policy. Standard "all risk" insurance policies may exclude theft of property that is not part of the building, and therefore, exclude theft of personal property. Care should be taken to be sure that such personal property is covered on a replacement cost rather than a depreciated value basis.

BOILER AND MACHINERY

A "boiler and machinery" policy will cover not only damage to a boiler and structures damaged by explosion of the boiler, but it will also cover sudden and accidental breakdown of other machinery such as pumps, compressors, heating/cooling equipment, and motors.

UMBRELLA COVERAGE

An association should have liability coverage of at least \$5 to \$10 million. However, most liability policies limit coverage to \$2 million. One way to obtain higher coverage limits is to purchase an umbrella policy, which covers liability to limits in excess of what is covered by the basic policy. An umbrella liability policy is broader in some areas than the basic

liability package policy. Umbrella coverage depends upon there being some underlying coverage to handle the liability up to a certain level, and therefore, the premiums on an umbrella coverage tend to be considerably less.

TITLE INSURANCE

When the new board of directors takes over the operation of the association from the developer, it should check to see whether or not the developer of the project purchased title insurance on property deeded over to the association. If so, that insurance can be relied upon in the event there is any problem with title to the association's property in the future. In a phased project, the board of directors might consider requiring a title insurance policy on any common area property that is annexed to the association as part of an additional phase.

PRODUCT LIABILITY INSURANCE

If the association operates dining or food service facilities or has vending machines which dispense food under its operation and control, it should include product liability coverage.

"CLAIMS MADE" or "OCCURRENCE" COVERAGE

In purchasing liability insurance, it is important to distinguish between a policy offering "occurrence" coverage and "claims made" coverage. Claims made coverage means that only claims which are made during the period that the policy is in force are covered. Even if the event causing the damage occurred during the period, if the claim is not made until after the expiration of such period, there will not be coverage.

Alternatively, if a claim is made during the period the policy is in effect but the event occurred before the policy went into effect, there may be coverage, depending upon whether or not the policy specifically excludes claims for events occurring prior to the period of coverage.

If the coverage is "occurrence" coverage, then the event causing the damage must occur during the policy period to be covered, even if the claim is made after expiration of the policy.

REPLACEMENT COST

Policies may be written to provide coverage based on replacement value rather than depreciated value. Unless otherwise specified, replacement cost means the cost to replace original kind and quality and does not cover upgrades. Endorsements are available to cover actual replacement costs including upgrades.

INFLATION GUARD ENDORSEMENT

It is possible to obtain an endorsement which provides that the amount of insurance will automatically increase by a specified percentage every year or by the amount of the increase in the cost of living index or some other construction cost guide. This is particularly important coverage to have during periods of rapid inflation.

BUILDING ORDINANCE ENDORSEMENT

If the project does not conform to present building or zoning codes, which is often the case with older communities, and such project suffers more than 50% damage, it cannot be repaired without bringing the building into compliance with current building codes and zoning ordinances. Normally, insurance would not cover the extra costs to bring the building

up to code or to add additional parking spaces, if that is what is required. These extra costs can be insured by special endorsement to cover changes in building ordinances since its original construction.

POLICY EXCLUSIONS

It is important to be aware of exclusions contained in policies that are "comprehensive", "special form" and "all risk". Generally, the following are excluded unless they are covered by specific endorsements: damage from termites, dry rot or fungus; damage from underground water; damage from rust; damage from settling; damage from animals or birds; damage from electrical shorts (unless fire occurs); glass damage; damage to signs are not generally included; exploding of steam boilers (see BOILER AND MACHINERY section); earthquake; flood; war; landslides; rain damage to interior of the building unless wind made the hole through which the rain was driven; water damage that occurs over an extended period of time.

WAIVER OF SUBROGATION

Under a standard insurance policy, an insurance company typically has a legal right to recover its loss from the parties who were negligent and caused the loss. Colorado law requires (for communities created after July 1, 1992) that associations' policies contain waiver of subrogation clauses against individual owners. This means the insurance companies cannot sue individual owners to try and collect amounts that the insurance company paid.

CO-INSURANCE

Many insurance policies require buildings be insured up to their full value or at least a substantial percentage of their full value. That is because the higher the value insured, the higher the premium. Insurance companies don't want to be in the position of having to pay more for a building than the amount of the insurance carried. As a result, many insurance companies require associations to carry 80% or more of the value of the building in casualty insurance. If you fail to carry that much insurance, a coinsurance clause says you will be penalized. Colorado law requires associations to buildings to their "full replacement value" for communities created after July 1, 1992. Therefore, we recommend associations carry insurance in the amount of 100% of the replacement value of the improvements.

HOW TO PURCHASE INSURANCE

Associations should only deal with insurance brokers who are experienced in handling homeowner association insurance. One way to determine is to ask the broker's level of experience and how many owners associations he currently insures. It is customary to get two or three bids or proposals from different insurance brokers or insurance agencies prior to acquiring the insurance policies. The same specifications should be given to each insurance agent prior to asking for a proposal. There is a great difference in the coverage and language of insurance policies offered by different companies. Since most insurance policies are so complicated that they are not easily read and understood, associations rely upon the expertise of their brokers for finding them policies that comply with the requirements of their governing documents and Colorado law, and provide the best coverage for the best rates.

Please do not hesitate to contact an Altitude attorney with any questions concerning association insurance at 303.432.9999.