

## Do You Have A Loophole in Your Condo Insurance Coverage?

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Few lenders know that they are not always an insured mortgagee under a condominium owner's policy. While on the surface this may not seem like an important issue, in reality there can be broad exposure to the lender.

Coverage for condominiums is typically dictated by the by-laws of the condominium owners association. The by-laws will specify who is responsible for insuring what property. For instance, the by-laws may dictate that the association is responsible for insuring the exterior of the units including all common areas and that the unit owner is expected or required to procure their own insurance for the interior of the units.

Generally speaking, most condominiums have two policies. One is for the Condominium Owners Association (COA) covering the building and common areas and may include a small coverage amount for the interior of the units. This policy is typically purchased by the Condominium Owners Association to which the Association is listed as the named insured. Sometimes the unit owner will receive a Certificate of Insurance as evidence that they are listed as an insured. The second policy is for the interior of the unit. This is a policy that the unit owner will purchase on their own. This coverage is usually a HO-6 policy and provides coverage for liability, personal property, and a small amount of real property which are generally fixtures including wall and floor coverings permanently attached to the inside of the unit. There is a small sub-limit for real property, sometimes as low as \$1,000. Both the insured and the lender can request higher limits and additional coverage at minimal cost. My recommendation is for the lender to require at least \$10,000 of coverage and request the insurer to send the Certificate of Insurance and show the Real Property limit. Most HO-6's are severely underinsured since the cost of cabinets, crown molding, carpet, interior doors, banisters, stairs, plumbing fixtures, and appliances can be very costly to replace.

Many lenders do not track their condos for insurance coverage. Instead, they rely on a Condo Master Policy that is written to insure the lender for any building loss. This coverage is usually provided by the force placed carrier. Logistically, this may be easier than tracking the coverage. However, the lender is essentially paying for double coverage. Since the lender may already be insured for the building and common areas under the HOA policy, this provides duplicate coverage. The loophole is that no efforts are being made to insure the interior of the units.

It is critical that lenders require both types of insurance. In the cases that the lender does require both types of insurance not all servicing systems are set up to handle two

different policy numbers. One policy number would need to be entered into the loan system for the building or association policy and one policy number would need to be entered for the unit owner's policy. Since there may be as many different lenders as there are units in a condominium complex, mortgagees are not typically listed on the association's policy. An area that is often overlooked is whether or not the mortgagee is listed on the individual unit owner's policy as an additional insured/mortgagee. This is an important issue and if you are not listed, then you may be left exposed in the case of a loss.

If there is a loss, then in the cases where the lender is not named on the policy, the lender will also not be named on the loss draft, but more importantly the mortgagee will not be an insured. If the mortgagee were to regain title to the condo through foreclosure (or other) procedures, then there is a high likelihood that the lender will receive the property with interior damage. Typically the lender could (and should) file an insurance claim against the insurance carrier for the damages. However, if the lender is not listed as an insured or mortgagee, they would not have the right to do so.

It is also important to remember the affects of the Standard or Union Mortgage Clause. This is also referred to as the Lender's Loss Payable Endorsement, Form 438 BFU NS. This clause is a separate insuring agreement between the mortgagee and the insurer. I cannot stress enough the power and importance of this clause. This clause protects the lender from the acts of the named insured (borrower). In a case whereby a borrower were to remove all of the property including cabinets, sinks, ceiling fans, appliances, carpet and any other fixtures from the condo, the lender would have no recourse. The lender or rather, the investor would be left holding the bag. It is also very likely that the investor would seek reimbursement from the servicer for not protecting their insurable interest in the property.

My recommendation to you is to review your internal policy to see if you or your investors require insurance on both the interior and the exterior of the unit. If so, are you currently tracking that information? Does your servicing system have the capability to track more than one policy number? Are you listed as an additional insured, mortgagee on the borrower's HO-6 policy?