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Condos and Additional Insureds

Abstract

Here's an issue that has come up several times in the past few months: The mortgage company on your insured's condo says that they want to be named as an additional insured on the condominium association MASTER policy. Needless to say, the master policy insurer refuses. How should you handle this situation?

Here are two recent questions received by our "Ask an Expert" service:

Q. "Can the mortgagee on a condo unit be added to the master policy as a mortgagee? How is his interest protected?"

Q. "I have never understood why banks (mortgagees) insist on being added as additional insureds to the policy insuring the real property for the association. It doesn't seem to me the bank has an interest in the association's real property when the mortgage is with an individual unit owner.

"Recently one of our major carriers has taken the position that they will not add an individual unit owner's mortgagee to the association's policy for this reason. We can provide evidence that the association maintains insurance, but cannot show the bank is included as an additional insured.

"An attorney pointed out that our state regulations governing condominium associations require any loss payment be made payable to the association (or association's trustee) and specifically states payment cannot be made to a mortgagee. The same regulation states the insurer must issue evidence of insurance and provide 30 days notice of cancellation via mail.

"Is it correct that a unit owner's mortgagee should not be added to the association's policy (I believe it is)? If so, how do we satisfy the requirement that mortgagee receive 30 days written notice via mail of a cancellation from the insurer?"

A. There is widespread ignorance and abuse of the entire issue of additional insureds in insurance. Too often you get an attorney, "risk manager" or other party who has no idea of the insurance ramifications or practicalities of additional insureds. Their solution to any insurance exposure is to have their client named as an additional insured on someone else's policy. Unfortunately, this is often not appropriate or impossible to do from a practical, or even legal, standpoint, and it can lead to problems not contemplated by the additional insured.

Below are some comments from our faculty on this specific issue:

Faculty response

This comes up on a very regular basis here in Florida. The fact is the unit owner's mortgage company should not be listed on the master policy. Just imagine a building with 100 units in it (very common in this state of over 20,000 condo associations) and a master policy covering the building. Further imagine that just half of the unit owners (50 on this case) have a mortgage. Now imagine the master policy with 50 mortgage companies listed. Then to top it off imagine a claim to the master building and in your mind imagine the check made payable to the association and 50 mortgage companies. The fact is there isn't an insurance company on the planet that's going to physically be able to list all those mortgage companies.

When the bank loans money to the unit owner they are in effect loaning money in order for that client to buy a "box of air." At least here in Florida it's that way. Not to pick on banks, but they just don't understand insurance. They have this thought, "If I loan \$125,000 of money then I need an insurance policy showing that amount of coverage and I don't care where it comes from."

As an example, very common here, a client buys an oceanfront condo with a whale of a view (pun intended) and pays \$400,000 for it. (Happens all day long here.) Of that \$400,000, about \$300,000 is for the view. Should a mortgage company see insurance for the \$400,000? Absolutely not, because they are loaning money for a view. We actually had an agent call recently saying their client paid \$150,000 for a condo. The bank wasn't requiring that it be named on the master policy, but wanted to see the HO-6 policy and stated it must have \$150,000 of building coverage or no loan. How ludicrous.

I've run this by the folks at ACORD and their recommendation was to use the ACORD Certificate of Property Insurance. (Yes, there is such a beast.) Show the bank as certificate holder and you're done. I've heard a few agents say they listed the bank on the HO-6 policy. I don't see that either, falling back on my statement that the loan is usually for a box of air or not much more.

Faculty response

I agree with everything you said from a practical standpoint, particularly why it's useless to add the mortgagee to the master policy. However, there are more issues concerning the HO-6. There IS a mortgagee clause in the HO-6, and a bank who loans anyone \$150,000 is going to want to see a piece of paper somewhere saying their investment is protected. The argument with the bank needs to follow the same one used for single-family homes. "You may have loaned this person \$300,000, but the replacement cost of the property is only \$175,000, which is all we are going to insure. The rest is for that lovely location on Lake Munson. Location, location, location." Additional support comes from statutes like the one in Florida that forbids lenders requiring overinsurance. Bottom line, though, is the unit purchaser is the one dealing with the lender & let THEM work it out. If the lender they choose to use requires Coverage A equal to the loan, and there are no statutes or regulations prohibiting it, then that's a cost of the mortgage and they'll have to grin and bear it, just like paying points. And since the insurance carrier will never pay that much, why should they care? Besides, my experience has been that the vast majority of unit owners underinsure Coverage A, so maybe this will actually help them out.

But I'm not sure this answers this person's question. Does the bank want 30 days notice of cancellation of the MASTER policy of the HO-6? (Why, I don't know since they have no interest in that property.) If it's the HO-6, name them on that one and be done with it. If it's the master, the ACORD form is an answer, if the company will honor it and give the thirty days notice.

Faculty response

Mortgagees lend money to fund the purchase of real property as opposed to personal property. It sounds to me like there are some education issues here. The mortgagee cannot be added to the association contract because they have no insurable interest in the buildings themselves. There is, however, real property for which they can be added as the mortgagee.

Coverage A under the unit-owners policy covers the additions and alterations the insured is responsible for replacing in the event of a loss. This can be several thousand dollars depending on how elaborately the interiors have been constructed. In essence, that is what is being sold to the buyer along with the "intangible air rights" to the interior of the space.

Faculty response

While we don't have a specific statute of that nature here in our state, when I was on the agency side we never added the individual mortgagees to the policy. We simply issued a Certificate of Property Insurance or an Evidence of Insurance.

Faculty response

Part of the answer as to why mortgagees want to be on the master policy:

1) It solves the problem of the regulatory inspection of collateralized loans. The banking laws require insurance on federally insured loans. How do you get an HO-6 with coverage A limits of \$1,000 and Coverage C limits of \$100,000 to cover a \$250,000 loan value? The banker uses the Association Master

Policy to cover the insurance requirement. (I know, the policy won't respond to the unit-owner mortgagee and don't even start on the \$1,000 coverage A point.)

2) The banking industry has not read the Condominium Association Policy.

3) The protection is there in a third party beneficiary area. Say the Association Building encounters a large loss to the structure. If there is no insurance to rebuild the structure, the unit-owner is out of a place to live. Would you continue paying a mortgage on the air you bought if it didn't have walls around it? Some/many insureds wouldn't.