



DESTINATION MAUI INC.
Property Management

Water Leak Insurance Claims in Community Associations

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This paper only deals with insurance claims as a result of water leaks. It does not address other types of insurance, i.e. D&O, fire, liability, flood and other policies typically carried by community/homeowner associations.

Introduction

There continues to be a great deal of misunderstanding among managing agents and directors regarding the question of who pays for damages caused by water leaks. The answers to these questions are answered in the following discussion.

Water leak problems are becoming a major issue because many buildings that were developed 30 to 40 years ago installed cast iron pipes. These types of drain/sewer pipes were used because plastic ABS pipes were not approved at that time. The cost of repairing these leaks can be substantial and can easily amount to tens of thousands of dollars particularly in multi-story buildings where many units may be affected.

Forward thinking boards have been replacing their cast iron pipes to avoid issues with deferred maintenance. This makes sense from a management standpoint because the cost of replacement can be controlled and spread over several years. The alternative is to wait for the leak to occur and replace the pipes at that time. This latter approach tends to be more costly since the resulting damage will likely be more substantial.

All “Resultant” Water Leak Damages are Covered by the Association’s Insurance Policy

A general principle in property insurance is that an insured casualty must occur to insured property before the insurance will pay for damages. However, in the case of water leaks, only the resulting damage will be covered. This is true regardless of the cause of the water leak.

Association insurance policies dealing with damages from water leaks do not cover the replacement of the item causing the damage. This is true for cast iron pipe failures. Only the resultant damage caused by the water leak is covered, not the repair or the replacement of the cast iron pipes. The theory behind this is that the water leak may have been due to the lack of maintenance and was not the result of a casualty.

In the case of a leaking roof, any resulting damage may not be insured (even resultant damage) if the roof leak is due to lack of maintenance. In order for the insurance coverage to apply, there must be a sudden and accidental damage to the roof. In other words, a casualty. If the roof leak is the result of a casualty, the repair to the roof and resultant damage to the *insured property* will be

covered. It should be noted that the association's master policy will only cover the unit(s) damages as it was originally built (i.e. appliances, fixtures, flooring, cabinets, etc.). There is no coverage for personal property or upgrades to the units (i.e. stone flooring, granite countertops, upgraded fixtures, etc.).

Types of Water Leak Damages that are Covered by Insurance

There are three types of water leak damages affecting associations:

1. Water Leaks affecting only common areas;
2. Water Leaks affecting only one or more units; and,
3. Water Leaks affecting both the common areas and one or more units.

Water Leak Damages Affecting Only Common Areas

In such cases, the association's insurance policy will pay for damages subject to the deductible.

Water Leak Damages Affecting Only One or More Units

The unit owner(s) will pay for the Association's deductible and the association's insurance policy will pay the balance as long as the damaged property is insured as defined in the insurance policy's declarations. This is true regardless of the source of the water leak. For example, if a unit owner negligently left the water on and it overflowed causing damage to the unit as well as other units, then the deductible will be charged to the negligent owner and the balance of the damages to the common elements will be paid by the association's master insurance policy.

This may seem counter-intuitive. Since the unit owner was negligent, shouldn't he/she be responsible for any resulting damages? The answer is that association insurance policies are considered as the *Primary Coverage* and State law now requires that the unit owner(s) are only responsible for the association's deductible. It should be noted again that this only applies to association property. The unit owner is still responsible for his/her personal contents as well as any upgrades to the unit. See the comments below on *Legal Requirements*.

Water Leak Damages Affecting Both the Common Areas and One or More Units

The answer will be exactly the same as above where the unit(s) owners will pay for the association's deductible and the association's insurance policy will pay the balance of the damage.

Legal Requirements

Chapter 514B-143(d), *Insurance*, states that "...The board, in the case of a claim for damage to a unit or the common elements, may:

- (1) Pay the deductible amount as a common expense;

- (2) *After notice and an opportunity for a hearing, assess the deductible amount against the owners who caused the damage or from whose units the damage or cause of loss originated; or*
- (3) *Require the unit owners of the units affected to pay the deductible amount...*

In addition 514B-143 (g) *Insurance*, states that “...*The board, with the vote or written consent of a majority of the unit owners, may require unit owners to obtain reasonable types and levels of insurance. The liability of a unit owner shall include but not be limited to the deductible of the owner whose unit was damaged...*”

These two provisions are mutually exclusive. In other words, even if the association is silent with respect to the requirement that all unit owners carry “reasonable” amounts of insurance, the board can still “*require the unit owners of the units affected to pay the deductible amount*”, as required in Ch. 514B-143(d)(3), above.

As a matter of policy, we feel that all associations should require that all owners carry a minimum amount of insurance at least equal to the association’s deductible. The individual unit policy is commonly referred to as an HO-6 policy. This policy is applicable regardless of whether the unit is owner-occupied, rented or left vacant,

We also recommend that unit owners consider using the same insurance carrier used by the association in order to minimize counter-claims between the insurance carriers when the insurance claim affects both the common areas and the unit.

Please feel free to contact is you have any questions of comments concerning this article.

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