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NEWS AND VIEWS

for Homeowners Associations

ABC'S OF CONSTRUCTION DEFECT CLAIMS

By Michael A. Hearn

Often times the question is asked exactly what a "Construction Defect" is. The purpose of this article is to provide some basic information concerning what they are and how they are identified.

Construction Defects are generally defined as original construction which is in violation of the applicable building codes, the approved plans and specifications, manufacturer's installation instructions and/or industry standards. Obviously, that information is fairly technical in nature and is confirmed by various consultants that have performed investigations after an owner becomes concerned with the construction.

The more important question for homeowners and Associations is how would you know that a potential Construction Defect exists. The most common way of recognizing a Construction Defect is to actually see manifestation of damages that result from the defect. That would include such things as water intrusion through roofs, windows, walls and decks; stucco cracks on the exterior of the building in excess of 1/16th

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UPCOMING HOA FREE BOARD SEMINAR! REAL PROBLEMS - REAL SOLUTIONS! October 23, 2014

In this seminar, four veteran HOA professionals will tackle the most challenging issues that face HOA Board members. Participants will be encouraged to bring their questions, however, below is a partial list of questions that will be addressed.

- Why is being a Board member so hard?
- My board is DYSFUNCTIONAL - what can be done?
- What are the most common misunderstandings about HOA insurance?
- Addressing insurance challenges regarding interior damage!
- How can we address APATHY?
- How can we put money into reserves when our dues are so high now?
- RENTERS: effective steps to address challenges!
- Balancing my role as an OWNER and BOARD MEMBER!
- And your questions too!

Arrive at 6:30 PM ; Enjoy dessert and mingle with HOA Service Providers. Raffle drawings from HOA Service providers in attendance. Seminar begins promptly at 7 PM.

SPEAKERS

The speakers each have over 25 years of experience in the HOA field, and collectively have been involved with over 10,000 homeowner associations.

- Kelly Richardson, Esq; Richardson, Harman Ober PC;
- Robert Nordlund, PE, RS; Association Reserves, Inc.
- Steve Segal, Farmers Insurance
- Dave Brock, PCAM; Beven & Brock

Reservations required: You can call (626) 795-3282, ext. 886 or register by email: HOASeminars@bevenandbrock.com. Please provide your name, Association name, number attending, and your email or phone number. We will confirm back to you the exact location.

*ABC'S of Construction Defect Claims:
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of an inch; doors and windows that are difficult to operate; excessive interior drywall cracking; retaining walls that have cracked or moved; and concrete flatwork that has heaved or settled.

Once one of these types of manifestations is identified, it would be at that point that an owner or an Association would contact a Construction Defect consultant to perform further investigations. Our firm provides an initial free investigation for all projects which includes a full investigation at the site, a review of the governing documents, a written report and then a consultation with the Board of Directors or the owners. The information from the initial investigation is invaluable as it not only identifies other manifestations of defects, but provides a full explanation as to the type of deficiencies.

It is also important to note that the Board of Directors have a fiduciary responsibility to its members to have such an inspection performed if there are manifestations of any type of construction issues. Under California Law, the Board of Directors have the responsibility to make sure that all members are protected from any damages that may arise as a result of Construction Defects.

Once construction deficiencies

have been identified, the next step would be to present a Notice of Claim to the original developer and general contractor which would allow them to perform their own inspection and possibly provide repair recommendations, at their cost. Should the developer and general contractor fail to respond, the owners and the Association could then proceed with a more formal claim through litigation.

One of the biggest defenses used during the litigation of a Construction Defect Claim are allegations that the owners or Associations have failed to properly maintain the property. Roof inspections should occur on an annual basis, which would include a visual inspection of the gutters as well. In addition, there should be scheduled painting and caulking of the exterior of the building, as well as providing new sealant on top of asphalt roads. There may be other maintenance items which should be regularly addressed, depending on the type of project.

Another question we get quite often is how Construction Defect Claims effect refinancing and sales at a project. While it is generally recognized that any type of litigation would have some effect on refinancing and sales, it has been our experience that refinancing and sales still occur. This is more difficult when there is specialized financing, such FHA or VA loans, but conventional lenders

generally just require a more thorough disclosure to them before they will agree to lend.

The most important thing to remember about Construction Defect Claims is if they are not made timely there are dire ramifications. When time has run out to make a claim against the original developer and general contractor, it means that the owner or the Association is then going to be responsible for making the repairs and paying for the repairs. Typically the cost of Construction Defect repairs is significant resulting in large special assessments to the owners in a multifamily project. For any multifamily project, we strongly recommend that well before the tenth anniversary of the project it be inspected by a construction consultant so that the Board of Directors has some assurance, before the time runs out, that the project was built correctly.

About the Authors: The Law Office of Michael A. Hearn specializes in Construction Defect Claims and has been almost solely involved in this area of the law for more than thirty years. The firm has represented in excess of 250 Homeowners Associations and is considered one of the leading law firms in this area in the entire state of California. Mr. Hearn can be reached at: info@mhearn.com, or by phone at (949) 341-0030. The firm's web-site is: www.michaelhearnlaw.com

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UNDERSTANDING THE ASSOCIATION'S MASTER POLICY PROVIDES REGARDING DAMAGE TO THE INTERIOR OF THE UNITS?

When shopping for insurance most Boards ask the agent/broker to match the Association's current coverage and hopefully, at a lower premium. In other words, "same coverage" for "less premium."

Proposals will take different forms depending on both the professionalism and experience of the agent/broker doing the presentation. Some will present every "nook and cranny" (Coverage for Fire Department Service Charge, Fire Extinguisher Recharge, Newly Acquired Buildings as well as Master Key) of the policy. While this coverage's should not be minimized, it isn't what Board members should focus on in their comparison.

Many proposals show the amount of Building coverage, Building Deductible, Specified Property (free standing walls, pools, clubhouse, guard house, walkways, streets, light poles, swimming pools, Jacuzzis), Building Code Upgrade, General Liability, Hired/Non-Owned Auto Liability, Directors & Officers Liability, Fidelity Bond, Workers Compensation as well as Earthquake coverage and Flood Insurance options coverage.

Most claims submitted by Associations apply to the building coverage of the insurance policy. They include but are not limited to such perils as: fire (including smoke), wind storm damage, falling objects (mainly trees), an automobile that runs into the building or entry gate and damage

from rain or flooding that enters a unit. However, water damage from a broken pipe, washing machine hose, flex line connections and ice makers that break leads the way as the most frequent cause of damage and claims for Associations.

Let's start with the different types of interior building coverage provided by insurance carriers:

1. "Walls In" ("--All Inclusive) also known as "Improvements, Betterments & Upgrades" coverage. This includes the following within the individual unit: floor coverings (marble tile, wood, carpeting, etc.), wall coverings, bathtubs, showers, plumbing fixtures, electrical fixtures, built-in cabinets, countertops, built-in appliances, toilets and wash basins. This may be issued in one of several formats:

a. "Included" provides unit owner coverage that is included in the total building limit. The only deductible applied is the Property Deductible. One deductible per occurrence.

b. "Blanket" provides unit owner coverage as a single limit amount for all units and is separate from the building limit. For example, \$500,000 has been designated as the blanket amount to cover any and all interior damage. If five units are totaled by fire; the interior costs may exceed the existing agreed upon blanket

limit coverage. If this happens then the Board would most likely have to assess each owner of the complex to make up for the underinsured portion of the loss. Also, be aware that this approach usually results in two deductibles being applied at the time of loss. One for damage to the unit owner's interior and another for damage to the common area. c. "Per Unit" provides a maximum dollar amount that will be applied per loss per unit. Example, the insurance policy is issued showing \$50,000 maximum "improvements and betterments coverage per unit. Problem: The Board would have to inspect each unit to determine what would be the maximum amount of per unit coverage would be required in order to avoid being underinsured. Also, like the "blanket" improvements & betterments option, this also carries two deductibles per loss.

2. "Walls In" excluding Upgrades. When written under this policy form, such a policy would cover damage to floor coverings (marble tile, wood, carpeting, etc.), wall coverings, bathtubs, showers, plumbing fixtures, cabinets, countertops, built-in appliances, toilets and wash basins, but only to the original building specifications. Damage to upgrades (carpeting to hard wood floors or tile to granite counter tops) made by the unit owner will be at his expense to repair.

3. "Walls Out" also known as "Bare Walls" coverage excludes the following types of property contained within the unit: floor coverings (marble tile, wood, carpeting, etc.), wall coverings, bathtubs, showers, plumbing

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Understanding the Association's Master...: continued from page 3.

fixtures, cabinets, countertops, built-in appliances, toilets and wash basins. The Association's insurance policy will only restore/rebuild to the unit to the drywall/sheetrock. The unit owner is responsible for restoring/rebuilding all the damaged property such as the cabinets, counter tops, carpeting, etc.

When reviewing insurance proposals, Boards should be cognizant of the type of interior coverage required by their Governing Documents as well as those required by the lending institutions. However, because many Associations CC&R's have not been rewritten in years, they may be open to various interpretations (depending on who is reading them) as to what the insurance policy should cover. When this is the case, many Boards take the "high road" and elect to go

with "walls in" protection with insurance companies that don't rely on the interpretation of the CC&R's.

Unfortunately, while looking to lower premium, many Boards have unknowingly gone from an insurance policy that provides "Walls In" protection to one that will only cover Improvements & Betterments if so dictated by the CC& R's. This puts the Board in a precarious situation, because they wouldn't know until a claim occurs (and the insurance carrier reviews the CC&R's) as to whether the interior of the units are covered.

Here's the dilemma—does the board have any liability exposure if they fail to inform the unit owner of this situation, thereby preventing them from getting such protection under an individual (HO-6) policy?

The Davis-Stirling "Disclosure Requirements" §5300(a) (b), states "The Association shall, as soon as reasonably practicable, notify its members by first-class

mail if any of the policies described in paragraph (1)have been replaced, or if there is a significant change, such as a reduction in coverage or limits or an increase in the deductible, as to any of those policies.

In order for Boards to prevent these types of situations, it is important that they have it specified on the insurance proposal as to what interior damage the policy includes on a covered loss. Ask to have a knowledgeable insurance Agent/Broker explain it as well as put it in writing. If you are not comfortable with the explanation, you may ask to review "specimen copy" of the policy.

Steven G. Segal has been Farmers' Insurance #1 insurer of condominium associations nationwide for over 35 years. Mr. Segal can be reached at (800) 345-8866 ext 224 or by email at steve@segalins.com

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