# CHAPTER 2. PROPERTY INSURANCE EXPLANATION AND REQUIREMENTS

## 2-1. PROPERTY COVERAGE.

Property insurance policies shall be written to cover all HA-owned property based on their current replacement value including equipment and furnishings. The policy does not cover property owned by a tenant, and it is the tenants responsibility to insure their household property if they desire to do so.

The majority of insurance companies providing commercial property insurance either use the three coverage forms designed and copyrighted by the Insurance Services Office (ISO), or coverage forms that are very similar. These forms are:

a. Basic Form: This form protects against loss from fire, lightning, explosion, windstorm or hail, smoke, aircraft or vehicles (non-owned), riot or civil commotion, vandalism, sprinkler leakage, sinkhole collapse, and volcanic action.

b. Broad Form: This form insures against all of the perils included in the basic form plus breakage of glass, falling objects, weight of ice, snow, or sleet, and water damage (not flooding).

c. Special Form: This form is considered to be an "all risk" form, providing more protection than the other two. Rather than listing the perils insured against, it insures against all causes of loss except those which are specifically not covered under the exclusions section of the contract.

The ACC requires a HA to purchase property insurance. However, the extent of the coverage is at the discretion of the HA, but the most comprehensive coverage (special form) is recommended. The cost is usually very little above the cost of the basic form.

None of the above forms cover damage as a result of an earthquake or land subsidence. If a HA is located in a fault zone or areas where underground mining has been carried out, the HA should check for the availability of coverage and if the cost is affordable.





## 2-2. AMOUNT OF COVERAGE REQUIRED.

The ACC requires that property insurance be written on a replacement cost basis. This means that the insurance will pay the cost to replace the destroyed or damaged property on the same premises with other property of comparable material and quality, or the actual amount spent to repair or replace, whichever is less. As opposed to insuring on an "actual cash value" basis, depreciation based on the age and type of construction of the property may not be taken into consideration when adjusting a loss. If depreciation is taken into consideration, it will produce inadequate values and the HA will become a co-insurer on each loss. In some cases, this method has produced per dwelling unit values of under $10,000 thereby abrogating the intent of the ACC insurance provisions, which is to protect the interest of the Federal government in the HA properties.

In order to obtain replacement cost coverage, the property must be in insured for at least 80% (preferably 100%) of what it would cost to replace the property. The following method may be used to determine the current insurable value and meet the ACC requirement:

a. Determine the original insurable value from Form HUD-5460, see Exhibit 1, then,

b. At each annual renewal date, increase the original insurable value by a percentage factor which should take into consideration any increased cost of construction due to labor and/or material costs. To assist HAs in arriving at these percentage increases, HUD is currently providing each field office with increased cost of construction factors. The factors, however, are regional in nature, and may be adjusted if local conditions warrant deviation.

c. The annual percentage increase should be equal to 100 percent replacement value which is the current insurable value.

2-3. ALTERNATE METHODS TO DETERMINE CURRENT INSURABLE VALUE.

If Form HUD-5460 is not available to the HA or to the Field Office, the HA may use either of the following methods:

a. Contract the services of a professional appraiser to determine the current or replacement cost of each building, or utilize the services of Marshall-Swift or Boeckh. These are organizations that specialize in publishing tables that can be used for this purpose.





b. Contact the local county or state building trades association for the current construction cost, by type of building construction (i.e., concrete, brick concrete/brick or frame). The association can provide a per square foot cost to replace each type of building. Multiply the per square foot cost by the total square feet in each building (do not include the square footage of a basement) to arrive at the current insurable value.

2-4. CONTENTS COVERAGE.

The current insurable value of HA property must include the HA owned contents of the buildings. Form HUD-5460 does not include the cost of office equipment or property in maintenance/community buildings. The HA must determine a reasonable replacement cost for these items and add their value to the total contents coverage required. Ranges and refrigerators are considered part of the building. The insurable value as shown on Form HUD-5460 does include the original cost of these appliances.

2-5. SPECIFIC SCHEDULED LIMITS VS. BLANKET POLICY.

The ACC requires that property insurance be written under a blanket policy which provides one limit covering the combined insurable values of all buildings and contents. This simplifies both the policy purchasing/maintenance procedures and the settlement of claims. It eliminates the possibility of under insuring individual properties.

2-6. AGREED VALUE CLAUSE.

Unless eliminated, policies contain a coinsurance clause which requires that the insured carry an amount of insurance equal to a predetermined percentage of the property value (e.g., 80, 90 or 100 percent). If a HA fails to carry the predetermined percentage, the amount paid for a partial loss is prorated in the same proportion as the difference between the carried limit and the required limit. This could act to penalize the HA. Therefore, the coinsurance clause must be removed and an agreed value clause used in lieu of the coinsurance clause.

2-7. DEDUCTIBLES.

Most policies have a provision requiring the HA to pay an initial predetermined amount of a claim. This initial payment is called a deductible. The deductible amount may range from $100 to over $25,000 per claim.





a. Cost Impact. Deductibles are applied on a per claim basis. The cost impact of the deductible must be measured by: (1) the amount of the deductible, and (2) the number of claims to which the deductible would apply.

Note: Because deductible amounts accumulate as the number of claims increase, deductibles higher than $250 generally are not recommended, except for HAs with 500 or more dwelling units. The deductible should not exceed the ability of the HA to pay the uninsured portion of all loses.

b. Evaluating Bids. When evaluating bids, which contain different deductibles, it is necessary to value the deductible based on the previous claim experience in order to determine the most cost effective alternative. For example:

Losses during prior 12 months:

(1) $15,000; (2) $8,000; (3) $20,000; (4) $2,000; (5) $4,000-- Total $49,000

| | Bid A | | Bid B |
|---|---|---|---|
| Deductible | $10,000 | Deductible | $5,000 |
| Annual Premium | $150,000 | Annual Premium | $160,000 |

If the losses for the next annual period were to follow the same pattern then the net cost of bid A would be $184,000 (The annual premium plus the deductible amounts not paid by the insurance company.) Bid B would net out at $181,000. Under this set of circumstances, bid B would be the more cost effective.

## 2-8. ORDINANCE OR LAW COVERAGE.

Many communities have building ordinances requiring that any building which is damaged to some extent (usually 50%) must be completely demolished and rebuilt in accordance with current building codes. None of the causes of loss forms described earlier provide this coverage. If a HA owns a building where building codes have changed since they were built, the HA should definitely consider adding an endorsement which would provide this coverage.





## 2-9. NOTICE OF CANCELLATION ENDORSEMENT.

This recommended endorsement provides that the insurance company will give the HA a minimum of 60 days notice prior to policy cancellation. (Individual state statutes may require more than the 60 days prior notice.)

## 2-10 REMOVAL OF VACANCY ENDORSEMENT.

This recommended endorsement provides for the removal of that portion of the policy that voids or restricts coverage on entire buildings left vacant beyond a specific period of time. The vacancy clause should be removed.

## 2-11 DAVIS-BACON ACT WAGE RATES.

When the damages covered under the property policy are in excess of $2,000 and amounts to reconstruction, the policy should require the insurance company to pay any additional labor cost under the Davis-Bacon Act, as amended (40 U.S.C. 27a-5) A separate endorsement is needed to this effect.

2-12 BUSINESS INCOME.

Although not a requirement, HAs may wish to consider purchasing this separate type of property insurance. Rather than insuring against replacing the property itself, this coverage would reimburse the HA for any loss of rental income while the premises were untenable due to a covered cause of loss. In evaluating the need for this coverage, the HA should consider the reimbursement provision of the Performance Funding System.

2-13 BUILDERS RISK.

When a new building is being constructed for a HA, a separate builders risk insurance policy is required. This can either be purchased by the HA or by the contractor. In either event, the policy should name the HA, the contractor, and any subcontractors as insureds. It is not necessary to obtain a separate builders risk policy to cover alterations or repairs to existing structures since this is covered under the form used for completed structures.

2-14 PARTIES INSURED.

The HA should be shown as the named insured. The U.S. Department of Housing and Urban Development should not be named as an insured.



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