

## The Condo Conundrum



At a time when condominiums and similar multi-unit, multi-owner housing projects are experiencing a resurgence to meet the growing demand for affordable housing, many insurers are avoiding these projects like the plague. Architects and engineers who design or who are thinking of designing condos now have to consider the insurance equation. As specialist insurance agents, we've had to go to great lengths to find our condo-designing clients affordable PL coverage.

So why the bad rap on condominiums? To begin with, insurance companies have shelled out huge sums due to claims involving construction defects on condominium projects. What's the cause behind these expensive defect claims? Consider:

*"Why the bad rap on condominiums?"*

- Condominium projects are often highly leveraged financially. When that is the case, developers are often more interested in saving dollars than building high quality projects. They may scrimp on materials and forego what they deem "optional" design services, such as construction observation.
- Condominium buyers are often unsophisticated when it comes to ownership issues. Many condo buyers have never owned a unit in a shared multi-family community before.
- They become part of a homeowner association in charge of upkeep and maintenance. These associations are often

not eager to pay for the full range of upkeep services needed to maintain the shared exteriors, roofs, utilities and common grounds.

- Attorneys are well aware of these first two bullet points. Unfortunately, some lawyers recognize condominiums as litigation goldmines. They actively solicit homeowner associations as potential clients and often urge these associations to provide a very critical review of the complex in a search to find defects with their buildings and grounds. If the developer scrimped on quality, it probably won't take long to find a reason to file a demand.
- Once a complaint or lawsuit is filed, the developer may be nowhere to be found. In fact, the developer may be a shell corporation that was set up solely to build and sell a single project. Once the last unit sells, the corporation dissolves.
- Similarly, if you are really unlucky, the low-bid contractor hired to construct their first condo project has dissolved, went bankrupt or otherwise disappeared once the project was completed.

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- So the only deep pockets remaining are those of the design team.

*“Insurers see condos as multi-million-dollar claims waiting to happen “*

Now, that’s not to say all condominium developers are shady, or that all condo projects are disasters waiting to happen. It is just that from an insurance company’s standpoint, condos have a checkered history. Insurers see condos as multi-million-dollar claims waiting to happen and, therefore, are not eager to provide coverage. In today’s market, with limited capacity, higher rates and an emphasis on profitability rather than market share, many insurers can afford to just say no to condos.

So where does that leave a design firm that has an opportunity to work on a lucrative condominium project? Does this conundrum mean you have to turn down any developer who approaches you with a potential job? Of course not. You just have to enter the waters knowing the dangers and take the steps necessary to minimize the risk. And in this venture, your knowledgeable insurance agent or broker can be invaluable in getting your condo work insured.

### **Choose Projects and Clients Carefully**

When considering accepting a condominium project, choose your dance partners carefully. This may be the most critical step to avoiding a potential nightmare.

Select clients with good, clean and hopefully long track records of producing quality condominium projects. Ask them about their previous projects and litigation history. Get a list of references from past designers. Contact them and ask about any project disputes or lawsuits. Try to gauge the developer’s commitment to quality.

If you have a few doubts after reviewing the developer’s track record, but aren’t quite ready to rule them out, examine the client’s financials. There’s nothing wrong with checking credit histories, asking for financial statements and the like. However, be ready to reciprocate if you receive a similar request from the client.

This is also a good time to ask about the contractor. If the client has one chosen, meet with or at least talk with the principals and review their condo history.

Ask whether they would be willing to provide a “constructability” review of your design.

If a contractor has not been selected, ask that you be made part of the review process. Consider making your involvement with the project contingent on your acceptance of the contractor.

Also learn as much as you can about the project itself. Are there any unusual requirements? Does the geography present any unique challenges? Are there other condominiums in the area and do they have any history of disputes and litigations? Is the fee worth the risk?

Consider how your skills and experience match the project. If you’ve never gone solo with a condo project, are you sure you are up to the challenge? You may need to hire or subcontract to others with more condo experience.

Those selections will be crucial as well. Make sure your subconsultants are well versed in the project and well covered with PL insurance of their own.

Finally, get your insurance agent involved in your condo decision. Share what you’ve found and seek advice. Your agent can give you an idea of what coverage is available in the current market and a ballpark as to the rates being charged.

*“...get your insurance agent involved ...”*

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### *About Crow Friedman Group*

*Crow Friedman Group is the leading professional liability insurance agency in Tennessee for design professionals, serving over 500 business concerns throughout the state of Tennessee.*

*Our regional offices are located In Memphis and Nashville, Tennessee. We serve the professional needs of architects, engineers, surveyors, certified public accountants, attorneys, real estate agents, and financial planners.*

*Crow Friedman Group offers a comprehensive list of insurance programs for professional liability as well as business and financial coverages.*

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They'll also know whether project-specific insurance is available and, if so, how to sell the advantages of this owner-financed coverage to your client.

### Condo Contracts

Let's say your condo project checks out and you decide to go ahead with the project. You'll want to pull out all the stops when it comes to securing protective contractual language. In fact, you'll want to make some of these clauses mandatory. If you can't negotiate them into your contract, it might be best to walk away from the project.

Of great importance is a limitation of liability clause. In most cases, the developer has a significant profit potential from a condominium project. It is only right, then, that they be willing to take on a significant risk. Demand that your liability on the project be limited to some reasonable level, such as the fee you earn on the project. Further, require that a limitation of liability provision in favor of the design team be included in the condo documents.

Make construction observation a required service on your part. You'll want to be able to observe construction and ensure that the contractor adheres strictly to your design. This will also give you the opportunity to spot any potential trouble spots and work with the contractor to take corrective actions in a timely and cost-efficient manner. Pay special attention to substitution requests from the contractor or developer. Don't accept inferior or untested materials or systems. Depending on the developer's finances, you might also want to demand that



the owner maintain a contingency fund set aside to handle unanticipated expenses.

You'll want to maintain ownership of your instruments of service so that the developer doesn't take your design and replicate it at other project sites. You'll also want the right to terminate your services should the developer fail to live up to financial or contractual agreements. There are many other contractual clauses you might demand depending on the circumstances of your project.

Ask your agent to provide standard clauses that you and your attorney should consider. In addition, there are a couple of condo-specific clauses that you should fight to include in your agreement. The first is an indemnification and waiver that is granted in light of the increased risks associated with condominiums. The second is a clause that calls for adherence to a schedule of recommended routine maintenance of the condominium development.

Have your attorney consider the following sample clauses provided by XL Design Professional, a leading provider of PL insurance programs for architects and engineers and publisher of *The Contract Guide*:

#### INDEMNIFICATION FOR CONDOMINIUM PROJECT RISK

*The Client acknowledges the risks to the Consultant inherent in condominium projects and the disparity between the Consultant's fee and the Consultant's potential liability for problems or alleged problems with such condominium projects. Therefore the client agrees, to the fullest extent permitted by law, to indemnify and hold harmless the Consultant, its officers, directors, employees and subconsultants*

*(collectively, Consultant) against all damages, liabilities or costs, including reasonable attorney's fees and defense costs, arising out of or in any way connected with the services performed under this Agreement, except for the Consultant's sole negligence or willful misconduct.*

#### WAIVER

*In consideration of the substantial risks to the Consultant in rendering professional services in connection with this Project, the Client agrees to make no claim and hereby waives, to the fullest extent permitted by law, any claim or cause of action of any nature against the Consultant, its officers, directors, employees and subconsultants (collectively Consultant), which may arise out of or in connection with this Project or the performance, by any of the parties above named, of the services under this Agreement.*

#### MAINTENANCE MANUAL

*The Client agrees that the bylaws of the Homeowner's Association established for this Project will require that the Association will perform, as recommended in the Maintenance Manual, all routine maintenance, maintenance inspections and any other necessary repairs and maintenance called for as a result of these maintenance inspections. The bylaws shall also contain an appropriate waiver and indemnity in favor of the Client, the Consultant and his or her subconsultants and the Contractor if the maintenance recommendations contained in the Maintenance Manual are not performed.*

*"Ask your agent to provide standard clauses"*

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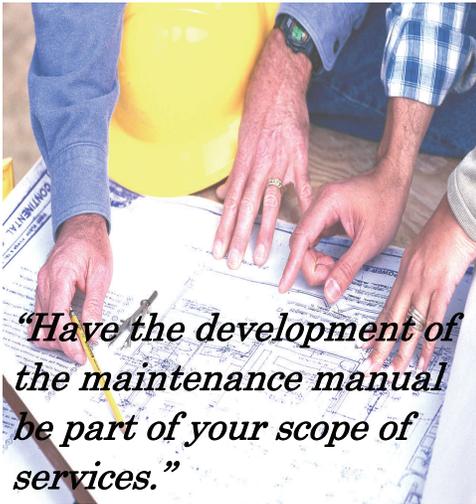
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***“Have the development of the maintenance manual be part of your scope of services.”***

Have the development of the maintenance manual be part of your scope of services. Then have the appropriate consultants working on the project develop written maintenance recommendations required for plumbing lighting, HVAC, roofing, decking, exterior walls, sidewalks, ponds and so on.

#### **Handle With Care**

Even with good contractual protection, condos can be risky business. That’s why it’s important to ensure your fee is adequate enough to offset that added liability. Work closely with your insurance agent when considering the project and when drafting your contract. That way, your agent will be knowledgeable about the project, client and contractor, understand the contractual and other protections you have obtained, and best be able to negotiate on your behalf to obtain needed coverage at an acceptable price.

#### **Can We Be of Assistance?**

*We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.*

This material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances. We would like to thank XL Insurance for their significant contribution to this material.

This article courtesy of Professional Liability Agents Network. (PLAN)



*Spring Into the Construction Season*

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#### **WELCOME JACKIE HALEN**

Crow Friedman Group is pleased to announce the addition of Jackie Hallen to our staff in the Memphis Office. Jackie comes to us with 20 years insurance experience specializing in Property and Casualty. Please join us in welcoming Jackie to Crow Friedman Group.