

## PRO-FORM INSURANCE SERVICES

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### Finding Condo Coverage

Any design firm that has taken on a condominium project or considered designing such projects knows the difficulty such work presents when looking for professional liability coverage. Insurance companies have suffered substantial losses from claims associated with residential condominium projects and will likely raise a design firm's insurance rates when such projects show up on the insurance application.

Why are condos so risky? Consider these factors:

- Condominium projects are often highly leveraged financially. When margins are thin, developers are very interested in controlling costs. They may scrimp on quality of materials, hire contractors on a low-bid basis and forego "optional" design services such as construction observation. Also, design fees are typically low because the developer can replicate a single design to produce multiple units.
- Because the same design can be executed over and over on a large condominium project, a simple design error or omission, or faulty construction means and methods, can also be replicated over and over. A single design or construction flaw that results in a leaky roof, wall or window can easily turn into a large class action suit.
- Condominium buyers are often unsophisticated when it comes to multi-unit ownership issues. They have no relationship with the designer and typically have little knowledge of the construction process. Homeowner associations in charge of upkeep and maintenance are often reluctant to pay for the full range of services needed to maintain the shared exteriors, roofs, utilities and common grounds. And when something goes wrong with their home, they often act emotionally to protect their substantial investment.
- Attorneys are well aware of these first three bullet points. Unfortunately, some lawyers recognize condominiums as litigation goldmines. They actively solicit homeowner associations as potential clients and urge these associations to provide a very critical review of the complex in a search for defects. 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. It is not uncommon for a condo developer to be a shell corporation set up solely to build and sell a single project. Once the last unit sells, the corporation dissolves. Similarly, a low-bid contractor may not have substantial assets or insurance. So the only deep pockets remaining are those of the design team and their insurance companies.

Certainly, not all condominium developers are shady. There are many highly reputable firms that build quality projects. But from an insurance company's standpoint, condos have a very checkered history. Insurers see condos as multi-million-dollar claims waiting to happen and they have yet to find a profitable way to underwrite them. Some may exclude condo work from coverage. Others cap the amount of condo work a design firm can have – e.g., no more than 10% - 20% of total projects. Some insurers have found that this cap only limits coverage to firms that "dabble" in condos and exclude those design firms most experienced in condo design. They are now insuring clients who do more

substantial condo work but require a near pristine claims record for both the designer and the developer.

Design firms with an opportunity to work on a lucrative condominium project have to enter the waters knowing the dangers and take the steps necessary to minimize risk. As a specialist insurance agency, we can often help in getting your condo work insured at a reasonable rate.

### **Project and Client Selection**

When considering a condominium project, choose your partners carefully. This is the most important step to avoiding potential problems.

Look for clients with long track records of producing quality condominium projects. Ask a potential client about its litigation history. Get a list of references from designers who have worked with this client. Contact them and ask about the client's experience, reputation and commitment to quality, and any project disputes or litigation. Learn as much as possible about any past claims. Try to gauge the developer's cooperative spirit in resolving disputes.

Ask to 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.

Determine whether a contractor has been selected for the project. If so, meet 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 to be made part of the review process. Consider making your involvement with the project contingent on your acceptance of the contractor.

Learn as much as you can about the project itself. Are there unusual design requirements? Does the geography present unique challenges? Are there other condominiums in the area and do they have any history of disputes and litigations? Is the project a new high-rise condominium (moderate risk) or a low-rise wood-framed project (higher risk)?

Consider how your skills and experience match the project. If you've never gone solo with a condo project, you may need to retain the services of subcontractors with more condo experience. Those selections will be crucial. Make sure your subconsultants are well versed in the project and well covered with PL insurance of their own.

Finally, get us involved in your condo decision. Share what you've found about the client, contractor and project. We can give you an idea of what coverage is available in the current market and a ballpark as to the rates being charged. We'll help examine any "owner controlled" or "wrap" policies your client may have and see whether it offers you any protection. We'll help you determine 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 further with the potential project. You'll want to pull out all the stops when it comes to securing protective contractual language. In fact, you may want to make some key contract clauses mandatory. If you can't negotiate sufficient protection

into your contract, it might be best to walk away. A knowledgeable client will understand your concerns and should be willing to provide reasonable liability protection. Any unwillingness to draft an equitable contract will also tell you something about your potential project partner.

Negotiate for a limitation of liability clause that caps your risk to a specific dollar amount, whether your project fee or your available insurance limits. In most cases, the developer has a significant profit potential from a condominium project. It is only right that they be willing to take on a significant portion of the risk.

Make construction observation a required service. You'll want to observe the jobsite and ensure that the contractor adheres to your design documents. This gives you the opportunity to spot potential trouble spots early and work with the developer and contractor to take corrective actions in a timely and cost-efficient manner -- before a claim situation develops. Pay particular attention to substitution requests from the contractor or developer. Don't accept inferior or untested materials or systems.

You'll want to ensure that the client maintains an adequate contingency fund to handle unanticipated expenses. It's also important to maintain ownership of your instruments of service so that the developer can't take your design and replicate it at other project sites. Negotiate the right to terminate your services should the developer fail to live up to financial or contractual agreements.

In addition, there are three condo-specific clauses that you and your attorney should fight to include in your agreement:

**Indemnification.** Have your client acknowledge in writing the special risks inherent in condominium projects and the disparity between your fee and potential liability. Have the client agree to indemnify you and hold you harmless against all damages, liabilities or costs (including legal fees) arising out of the services you perform under the contract, except for those costs that result from your sole negligence or willful misconduct.

**Waiver.** Again, recognizing the special risks of condo projects, have the client agree to make no claim and waive any claim or cause of action of any nature against you which may arise out of the project or the performance of your services under the contract.

**Maintenance.** Have your client agree that the bylaws of the homeowner's association will require that the association performs, 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 should also contain an appropriate waiver and indemnity in favor of you, your client and the contractor if the recommended maintenance services contained in the manual are not performed.

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

## **Risky Business**

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 the added liability. Call upon our services when considering a project and when you and your attorney are drafting your contract with the client. That way, we'll 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.*