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Don't Make a Costly Mistake When Hiring a Mitigation Contractor

Associations Need to Maintain Their Liability and Fiduciary Responsibilities

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Think about the last time your Association spent thousands of dollars without moving for a vote or hiring a professional to ensure the scope or price of a service provider or material supplier. Probably never, right?

Usually an Association embarks on a construction project only after weeks or months of planning and discussions with various professionals to determine the scope and estimated price of a job. This is all done to protect the financial interest of the unit owners and to ensure the quality of the work.

However, when an Association suffers a loss all of this careful planning goes out the window along with the usual concerns relating to Board of Director's liability and fiduciary responsibilities to the Association. In a hurry, the Board will typically assign all of the mitigation, reconstruction, and claim responsibilities over to a contractor. This "hurry up and get back to business" approach can easily lead to costly mistakes.

Following the initial cleanup phase, most situations no longer qualify as emergencies, and the Board and its Property Manager must take the appropriate steps to protect the unit owners. However, most Association Board's unknowingly sign away their rights to a contractor, led to believe that this will be a more efficient and cost effective way to repair the damage.

A Contractor's Work Authorization to perform mitigation services will typically include two clauses that most often do not receive the attention they deserve, (A) the option to have the contractor rebuild following the completion of the mitigation or emergency services and (B) to have the insurance company communicate and pay the contractor directly, otherwise known as an assignment of benefits. Some of these agreements even allow a contractor to sue an Association's insurance company if the insurance company does not pay the contractor directly or pay the contractor what they believe they are owed for their work.

An Association that elects to sign such an agreement has just made several critical mistakes. First, it has engaged a mitigation contractor to perform a totally different type of construction and scope of work without properly adjusting the loss. Unbeknownst to the Association and without its authorization, the mitigation contractors routinely obtain these rights from an association and never do the repair work. In fact, they commonly hire a subcontractor who is never included in the original work authorization agreement in order to perform that portion of the agreement. As a result, the Association may never obtain the name, license number, references, or general liability insurance information for this subcontractor.

The second mistake is agreeing to allow the mitigation contractor and/or its subcontractor to rebuild without having the faintest idea of the total cost of the construction project. This "quick-fix" strategy does nothing to protect the financial interests of the unit owners. It may also violate state laws and by-laws governing an Association and leave the Association liable for the repair costs, which may be substantial and not covered by the insurance company. It's an opened ended agreement with a blank check attached to it.

Lastly, an Association has tendered its rights to control the amounts payable to the contractor. The Association no longer has control over the contractor's scope of work nor when and how much the contractor will be paid. Also, the Association has effectively relinquished control of communications with the insurance company and the money it would otherwise be owed for its damages. It doesn't require a law degree to recognize the mountain of issues this assignment of benefits could cause the Association in the long run.

Here is a closer look at these important issues:

By-Law Violations

Following post-loss mitigation, an Association is no longer faced with an "emergency" situation. Neither the policy nor the by-laws require an Association to hastily obtain contracts to restore the damaged property once the loss has been mitigated. Meaning that the Association has stopped the loss from getting worse and has protected the unit owners from a hazardous situation. At that point, acting quickly without regard for normal business procedures puts each of the Board Members, as well as the Association and its Property Manager, in direct violation with most condominium by-laws and may even threaten the

health and safety of the unit owners.

As a fiduciary, the Board and its Property Manager must ensure that the Association is properly compensated for its damages before commencing repair work. **That means the adjusted value of a claim must be established before an Association can proceed forward.** Otherwise, the true value and scope of the Association's claim is anyone's guess. Using this information, the Board and its Property Managers must identify reputable and licensed contractors to bid the project. Unfortunately, the current trends with mitigation contractors and their agreements do not allow the Association to take the necessary and required steps to protect the unit owner's interest.

Contractors Put Their Interests First

Nowadays, mitigation contractors are offering continuing education classes to teach Association Board's about the insurance claim process *or so they claim*. Why are contractors suddenly so interested in teaching policyholders about insurance? Additionally, they are spending tens of thousands of dollars lobbying State Legislators to protect the policyholder's right to assign their claim benefits. Why are these contractors so interested in protecting a well-established policyholder right to assign benefits? On the surface, neither issue seems to have anything to do with construction, but think again. In fact, a number of them went as far as to provide public testimony for the protection of the insured's right to assign benefits at this past year's legislation session. Incidentally, nearly all of them testified to breaking the law by engaging in the unlicensed practice of Public Adjuster. The Florida law is quite clear:

Florida Statute 626.854 for "Public Adjusters" states the following:
(16) A licensed contractor under part I of chapter 489, or a subcontractor, may not adjust a claim on behalf of an insured unless licensed and compliant as a public adjuster under this chapter. However, the contractor may discuss or explain a bid for construction or repair of covered property with the residential property owner who has suffered loss or damage covered by a property insurance policy, or the insurer of such property, if the contractor is doing so for the usual and customary fees applicable to the work to be performed as stated in the contract between the contractor and the insured.
(18) A public adjuster, a public adjuster apprentice, or a person acting on behalf of an adjuster or apprentice may not enter into a contract or accept a power of attorney that vests in the public adjuster, the public adjuster apprentice, or the person acting on behalf of the adjuster or apprentice the effective authority to choose the persons or entities that will perform repair work in a property insurance claim.

These are two very important statutes that show why it's so important not to entrust or allow your contractor to handle the communications with the insurance carrier.

This newfound interest in policyholder's rights is very simple to understand. These contractors want to be directly paid by the insurance company without having to deal with the policyholder. If they can get in and out of a job without having to wait for a Board to convene and vote on a project, then they can speed up the process and get paid quicker. It's just another shortcut that has adverse consequences for an Association and its Board Members.

Let's cast aside the smoke and mirrors and dissect the issue further. As we have already discussed, before starting a construction project, many Associations hire a consultant or engineer to specify the details and to draft bid protocols. That can help in avoiding unnecessary liability when making costly decisions. However, turning responsibility for a repair project over to a contractor and the insurance company leaves the Board without any control over the outcome, which could lead to serious, adverse consequences for the unit owners. Secondly, the policy does not require the Association to rebuild in order to recover. The insurance company has an obligation to properly and timely adjust a loss; they have no right to police the repairs. In fact, the policy only requires the Association to exhibit their damages until the insurance company has completed its investigation and settled the claim with the Association.

In reality, most carrier adjusters and owners of mitigation construction companies have limited experience in construction. Some of these mitigation construction companies are even owned by former insurance company adjusters claiming to have an insider's edge on the claim process, but they are no longer on the inside. Even so, these contractors still need to preserve their relationships in order to expedite the claim and guarantee their payment. If these means resorting to value engineering or other cost cutting measures then they need to do what they have to do to get the job done.

Clearly, it is not in the Association's best interest to surrender its rights to a contractor or act in such a manner that would prejudice an Association's recovery. How exactly do you know what you're entitled to when the contractor has complete

control of your claim? Think about it.

Determining Construction Values

Since a licensed contractor under state law cannot engage in the adjusting of a claim, an association cannot rely on the contractor to represent its best interest in the claim process. It is not uncommon for these mitigation contractors to place more emphasis on their past experience with a particular carrier or adjuster to determine its scope of work rather than legitimate hands-on construction experience. The expeditious processing of these claims is essential to a contractor's own bottom-line and disputes regarding the scope may be left behind in order to protect a relationship with an Adjuster rather than the Association's best interest. Compounding these issues with the scope of work is the use of adjusting software, like Xactimate, to establish real values for these construction projects that quickly commence following a loss. Oddly enough, outside of the mitigation construction industry, few contractors rely on this same software to determine the true value of typical construction projects that are presented to Associations for proper vetting and review.

Recent studies have found that while the cost of construction has increased over the last three years, the pricing in Xactimate has stayed "relatively flat" over time. Why is this important? This means that mitigation contractors utilizing this software or similar systems are being forced to work for below market prices. Consequently, the only way to profit or complete a job within budget is to cut corners or implement alternative means of repairs, otherwise known as value engineering. These alternative means of repair do not restore the property back to a pre-loss condition and usually require the contractor to alter the building's systems, like re-routing of pipes or patching rather than replacing. This corner cutting and value engineering can potentially lead to increased cost of maintenance, a higher frequency of claims and the denial or underpayment of future claims.

Additionally, the Association pays a premium for insurance calculated based on the appraised value of the building. The appraised value of the building always takes into account current market conditions and construction cost. Below is a typical disclaimer found in most insurance appraiser's reports:

> The date of inspection represents the effective date of the Replacement Cost New opinion. Given the recent price fluctuations for building materials (there is currently an over-supply and limited demand for building labor and materials), the client is strongly advised to periodically update the replacement cost new estimate to prevent a situation of either "over/under insuring" the structure. The appraiser is valuing the property for a Replacement Cost Estimate for insurance purposes only. This is to replace the existing improvements in the event of total destruction including removal of existing improvements.

Interestingly, the cost databases in these adjusting software systems that are used to establish the value of the mitigation contractor's work are different than the cost databases and scope used by the appraisers that established the value of the Association's policy. These adjusting software companies claim to perform their own market studies even though licensed appraisers that follow the Uniform Standards of Professional Appraisal Practice typically only rely on Marshal & Swift/Boeckh, LLC cost databases. In fact, most of the construction industry outside of the world of mitigation contractors and insurance adjusters rely on different cost databases that provide entirely different results. Obviously, like with the corner cutting and alternative means of repair, this difference in pricing and scope may lead to shortfalls and inconsistency in the adjustment of a loss that benefit the insurance companies.

Who pays for the work?

Associations may misunderstand who is paying directly for the work. If it's the unit owners for a capital improvement project, then the board will typically take its time and hire the appropriate professionals to oversee and bid the job. However, if the carrier is directly paying for the construction project following a loss, then the Board will typically sign over its rights to a contractor and go back to business as usual.

But even though the assignment of benefits is a method of direct pay for the contractor, there can be a big difference in that repair charge and what the Association recovers for the loss. That disparity has a direct impact on the quality of the repairs, future claims, loss runs and the ability of the association to transact new insurance. It's the old, "pay me now or pay me later." That's why unlike any other type of construction project, the Association must first fully adjust and settle its loss in order to establish a budget and scope. Only then should the Association obtain bids to restore the damaged property, like any other construction project.

In fact, often the actual recovery for a loss is not the same as the actual cost of construction. Simply stated, the way an insurance company adjuster calculates the amount of the loss is typically different than how the insurance company calculated the premium amount. However, the Association is entitled to recover at the same rate it pays for insurance, which is derived from the appraised value of the building. If the labor and/or material rates used to determine the amount of the loss for the damaged portion of the building are less than the rates used in determining the premium amount paid by the Association for this same area of the building, then the insurance company is unjustly enriched by the shortfall. In this scenario the policyholder has essentially overpaid for insurance.

Since a contractor is not licensed to adjust claims, then an Association without its own proper representation cannot ensure an adequate recovery from a loss. Most often, policyholders confuse the idea of *rebuilding* with *recovering* from a loss. An Association must first *recover* in order to properly *rebuild*. *Recovering* from a loss means ensuring that an Association is properly paid for its loss and damage. In the insurance industry this is better known as indemnification.

What's The Solution?

As with any major construction process, the solution is hiring an outside professional to provide objective advice on (A) the scope of the project (B) the cost of repairs and (C) how to maximize the recovery from the insurance carrier. After all, you may already retain:

- a lawyer to handle your legal issues,
- an accountant to file taxes or set reserves,
- and/or even, an insurance consultant to help the Association place insurance.

Before an Association suffers a loss, the Board and its Property Manager need to understand the extent of its policy coverage and the process for filing a claim. If an Association does suffer a loss, the Board and its Property Manager need to follow their customary fiduciary and legal procedures. In all these areas, a public adjuster or other qualified insurance professional can help the association avoid making costly mistakes.

While many people believe there are negative consequences for hiring a public adjuster, the data says otherwise. In 2010 the State of Florida conducted a study and investigation into the impacts of public adjusters on claim settlements. The results published in the report, OPPAGA Report No. 10-06, speak for themselves: "Policyholders with public adjuster representation typically received higher settlements than those without public adjusters. Policyholders that filed catastrophe claims… generally received larger insurance settlements than policyholders that did not hire these persons. Public adjuster claims result[ed] in payments that were 747% higher."

The report also stated that, "[t]he number of complaints, investigations, and disciplinary actions against public adjusters is generally low."

The general rule of thumb for handling a claim is to mitigate, STOP, negotiate and settle the claim, and then rebuild. Rebuilding before a claim is settled and paid by the insurance company may have long-term adverse impacts on the Association. Insurance policies are complex and need to be reviewed in as great a detail as the contractor's scope of work and estimates completed by insurance company adjusters. Without the proper knowledge and resources, an Association's Board is taking unnecessary risks that have disastrous consequences.

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