

FHA Multifamily Housing Policy Handbook TABLE OF CONTENTS

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1 UNIT 2 ONGOING ASSET MONITORING

2 CHAPTER 2.3 INSURANCE AND LOSS DRAFTS

3 2.3.1 PURPOSE

4 A. Insurance Protection

5 Insurance protects projects, and by extension, their loans against loss or
6 damage. This chapter provides requirements and recommendations for
7 insurance coverage for FHA-insured and other HUD multifamily properties.

8 B. Equal Monthly Payments

9 HUD requires that lenders of FHA-insured loans collect equal monthly payments
10 sufficient to pay the estimated amount of fire and other hazard insurance
11 premiums, within a period ending on the dates on which they become due.

12 Property insurance is required to be in amounts established by HUD, and must
13 contain a clause making any loss payable to the lender/servicer and HUD, as
14 their interest may appear.

15 C. Fire and Hazard Insurance

16 The mortgage must contain a covenant binding the mortgagor to maintain fire
17 and extended coverage insurance on the property, in accordance with terms and
18 conditions established by the Commissioner, as required by 24 CFR 200.86,
19 "Covenant for fire and other hazard insurance."

20 D. Exclusions

21 This chapter does not identify or describe all of the possible forms of coverage
22 available to owners. Industry providers are constantly adding, removing, and
23 changing forms of coverage, and it is important for owners to be aware of
24 changes that may impact their current policies.

25 E. Owner Compliance

26 This chapter provides procedures for HUD to monitor owner compliance. Also
27 included are instructions to process loss settlement drafts issued in settlement of
28 insurance claims.

29 F. Insurance Monitoring

30 1) Lenders (or owners of HUD-held projects) must continually monitor the
31 insurance policies over the term of the loan so that each property is

1 continuously insured with acceptable and adequate property and liability
2 insurance policies.

3 2) Owners must keep the property insured at all times against such hazards
4 required by the lender.

5 3) Lender/servicer has the ability to escrow or not escrow other insurance types
6 upon agreement between the lender/servicer and the borrower.

7 The following sections identify the types of insurance and the specific provisions
8 that must be included or may be desirable in each property coverage policy.

9 **2.3.2 APPLICABILITY**

10 A. This chapter provides guidance for projects in the following categories:

11 1) Section 221(d)(3) and (d)(4) under Section 221 of the National Housing Act
12 (12 U.S.C. 1715l). Regulations are at 24 CFR Part 200, Subpart A, and 24
13 CFR Part 221, Subparts C and D

14 2) Existing housing Section 207 pursuant to 223(f) under Section 223(f) of the
15 National Housing Act (12 U.S.C. 1715n(f)). Regulations are at 24 CFR Part
16 200, Subpart A, and 24 CFR Part 207

17 3) Section 223(a)(7), National Housing Act, 12 U.S.C. 1715n(a)(7), insurance
18 for refinancing FHA insured loans as well as HUD-held loans

19 4) HUD-owned properties

20 5) Mark-to-market (M2M) program authorized under Multifamily Assisted
21 Housing Reform and Affordability Act (MAHRA) of 1997 (42 U.S.C. 1437).
22 Regulations are at 24 CFR Parts 401 and 402

23 6) Risk sharing loans, authorized under Section 542 of the Housing and
24 Community Development Act (HDCA) of 1992 (12 U.S.C. 1707). Regulations
25 are at 24 CFR Part 266 for the Section 542(c) program

26 7) Cooperative housing under Section 213 of the National Housing Act (12
27 U.S.C. 1715e). Regulations are at 24 CFR Part 200, Subpart A, and 24 CFR
28 Part 213

29 8) Urban renewal area loans under Section 220 of the National Housing Act (12
30 U.S.C. 1715k). Regulations are at 24 CFR Part 200, Subpart A, and 24 CFR
31 Part 220

32 9) Section 202/8 subsidized projects under Section 202 of the National Housing
33 Act of 1959, as amended by Section 801 of the Cranston-Gonzalez National

1 Affordable Housing Act of 1990 (12 U.S.C. 1701q). Also, Section 231 Elderly
2 Housing authorized under Section 231 of the National Housing Act (12 U.S.C.
3 1715v). Regulations at 24 CFR Part 200, Subpart A, and 24 CFR Part 231

4 10) Section 811 Supportive Housing for Persons with Disabilities under Section
5 811 of the Cranston-Gonzalez National Affordable Housing Act of 1990 (42
6 U.S.C. 8013). Regulations are at 24 CFR Part 891

7 11) Other HUD-held projects in addition to those addressed in 9) and 10) above.

8 **2.3.3 REQUIRED INSURANCE**

9 A. Insurance Coverage

10 Throughout the life of the mortgage contract, the owner, including cooperatives,
11 must have insurance coverage for the property that meets the requirements of
12 the mortgage. All of the policies listed below must be obtained to the extent they
13 are applicable to the property. The required types of insurance and amounts of
14 coverage by type include:

15 1) Fire and extended coverage insurance – This section of the policy covers
16 materials and supplies necessary to rebuild or repair the project.

17 a) The lender responsible for an insured loan (or owner of a HUD-held
18 project) is responsible for ensuring that insurance is in an amount that will
19 comply with the mortgage. Provided there is no co-insurance clause in
20 the policy, this amount is either 80 percent of the replacement costs of
21 the insurable improvements and equipment, or the unpaid balance of the
22 insured mortgage, whichever is less. To determine the amount of
23 insurance required at project completion, lenders/servicers must use the
24 replacement cost value shown on form [HUD-92329](#), “Property Insurance
25 Schedule.” In later years, after final closing, the lender must adjust
26 replacement cost value figures on form HUD-92329 to reflect changes in
27 construction costs that have occurred since project completion.

28 b) A co-insurance clause may not be used in the policy unless the policy also
29 contains an “agreed amount” provision. The agreed amount provision
30 must be equal to the replacement cost amount which must be itemized by
31 building when the property consists of multiple buildings.

32 c) The maximum deductible may be the greater of \$50,000, or one percent of
33 the aggregate replacement cost of the covered buildings, not to exceed
34 \$250,000. If the owner is unable to obtain a policy that provides for these
35 deductibles, increased deductibles may be allowed, provided that:

- 1 i) the owner has liquid assets of at least four times the deductible
2 amount; and
- 3 ii) the owner is in good standing with HUD document requirements, and
4 the most recent Real Estate Assessment Center (REAC) physical
5 inspection score is above 60.
- 6 d) Each policy must contain a standard lender clause to read: "loss payable
7 to the mortgagee, its successors and assigns".
- 8 e) Unless state law provides otherwise, fire and casualty policies must
9 provide that the insurer notify the lender in writing at least 30 days prior to
10 cancellation of the policy, and at least 10 days prior to cancellation or non-
11 renewal for nonpayment.
- 12 f) Fire insurance generally has four components:
- 13 i) Dwelling coverage offers protection against direct physical damage
14 caused to the dwelling, including rooms, fireplaces, carpeting, tile
15 floors, and elements of decor. Structures, which are attached to the
16 insured dwelling on the same foundation, are also subject to coverage
17 under this section of the insurance.
- 18 ii) Other structures, such as a garage, outbuilding, or storage shed that
19 are separate from an insured dwelling by a clear space, or connected
20 only by a fence or utility line. Dwelling policies provide coverage for
21 other structures. This coverage is sometimes called "appurtenant
22 structures" coverage.
- 23 iii) Personal property is tangible and intangible goods, such as furniture,
24 equipment, and other assets that are not legally considered as real
25 property. Personal property is property owned by the borrower, and is
26 not fixed or immovable. Personal property may also be referred to as
27 "personalty."
- 28 iv) Loss of use coverage (may also be known as business interruption) is
29 compensation for loss caused by the policyholder's loss of use of his
30 property. This coverage can include compensation for the period of
31 non-occupancy while a burned building is restored. A common
32 standard of compensation is rental value of the premises, but the
33 period of loss must be "reasonable," meaning the damages will be
34 limited to a period in which a person would normally and promptly
35 arrange reconstruction of the building or premises.
- 36 2) Water damage insurance is protection in the event of accidental discharge,
37 leakage, or overflow of water from plumbing systems, heating, air

- 1 conditioning, and refrigerating systems, and rain or snow through broken
2 doors, open doors, windows, and skylights that results in damage or
3 destruction of the property is scheduled in the policy. This type of water
4 damage coverage can be acquired through an endorsement of a standard
5 property insurance policy.
- 6 3) Business income and extra expense insurance – The coverage offered for
7 businesses against loss of profits and continuing fixed expenses during the
8 time that a business must stay closed while the premises are being restored,
9 following physical damage from a covered peril, such as a fire. It is also called
10 business interruption insurance, formerly use and occupancy insurance.
- 11 a) Such coverage must be maintained for each building from which revenues
12 are pledged to payment of debt service requirements.
- 13 b) The amount of coverage must be sufficient to make required debt service
14 and escrow payments. The proceeds of such a claim must be deposited
15 into an escrow account to make such debt service payments.
- 16 c) The available insurance limit must equal the sum that would normally have
17 been available for such purposes from the revenues of the damaged
18 building during the time the building cannot produce revenue after a loss
19 caused by perils. Losses caused by perils are covered by the project's fire
20 and extended coverage insurance.
- 21 4) Comprehensive general liability insurance – The insurance industry is
22 phasing out the term comprehensive. (see [commercial umbrella coverage](#)).
23 This insurance protects the owner against potential damages such as:
- 24 a) Operations and premises coverage protects against bodily injury or
25 property damage while the person is in the owner's office or business
26 premises. This can be extended to protect against any damage an
27 employee may cause while on the owner's premises. This may also
28 include elevator or escalator coverage.
- 29 b) Independent contractor's coverage protects against acts of negligence by
30 an independent contractor that results in bodily injury or property damage.
- 31 c) Personal injury coverage protects against claims for damage caused to
32 the person's reputation, character, and position in the community. The
33 protection includes lawsuits arising from slander or libel.
- 34 d) Generally, damage caused intentionally and contractual liability are not
35 covered under liability insurance policies.

- 1 e) At a minimum, liability insurance must provide \$1 million per occurrence
2 and a \$2 million annual aggregate for one property. An umbrella or excess
3 liability policy should provide coverage at a rate of \$1 million per
4 occurrence and a \$2 million annual aggregate for each story above three
5 stories, up to a maximum \$10 million annual aggregate.
- 6 f) When a claim is made, the insurance provider has the right, and the duty,
7 to defend the insured. The legal costs of defense normally do not affect
8 policy limits unless the policy expressly states otherwise; this default rule
9 is useful because defense costs can be extreme when cases go to trial.
- 10 g) Each general liability policy must contain a standard additional insured
11 provision.
- 12 5) Workers' compensation insurance – A system whereby an employer must
13 pay, or provide insurance to pay, the lost wages and medical expenses of an
14 employee who is injured on the job.
- 15 a) This insurance provides four types of benefits as a matter of right to the
16 employee, without regard to fault:
- 17 i) cash or wage loss benefits;
- 18 ii) medical and career rehabilitation benefits;
- 19 iii) in the case of accidental death of an employee, benefits to
20 dependents; and/or
- 21 iv) rehabilitation benefits for employee job-related injuries.
- 22 b) Independent contractors are not entitled to workers' compensation
23 benefits.
- 24 c) Workers' compensation insurance may be purchased from a private
25 company or a state-owned fund in those states that provide such a fund.
- 26 6) Boiler and machinery insurance – The term boiler and machinery is a
27 misnomer in that modern policies cover much more than just boilers and
28 production machinery. Boiler and machinery insurance provides coverage
29 against the sudden and accidental breakdown of boilers, machinery, and
30 electrical equipment. The broad form of coverage is referred to as the
31 comprehensive form for small businesses since it covers a broader range of
32 equipment. Coverage is provided for any boiler, fired or unfired pressure
33 vessel, refrigeration or air conditioning equipment, and mechanical or
34 electrical equipment, among others.

- 1 a) Most property policies have four basic exclusions that make boiler and
2 machinery coverage necessary. This would include not only physical
3 damage to the property (building, contents, equipment, and inventory), but
4 indirect damage, such as business interruption or extra expenses. These
5 exclusions include all losses caused by
- 6 i) explosion of steam boilers, steam engines, steam turbines, or vessels
7 under steam pressure;
- 8 ii) electrical arcing (short circuits) of motors, generators, circuit breakers,
9 electrical distribution boards, cables, and transformers;
- 10 iii) mechanical breakdown; and
- 11 iv) centrifugal force.
- 12 b) Coverage under a boiler and machinery policy is provided for:
- 13 i) damage to the equipment;
- 14 ii) expediting expenses which pays the reasonable extra cost incurred to
15 expedite progress after a loss;
- 16 iii) property damage to the property of others;
- 17 iv) supplementary payments; and
- 18 v) additional objects.
- 19 c) The insurance must be no less than the replacement costs of the property
20 plus the replacement costs of the covered equipment. Deductibles may be
21 a maximum of \$50,000 for replacement costs up to \$10 million, or \$75,000
22 for replacement costs of \$10 million or more.
- 23 d) If the boiler and machinery insurance carrier is other than the carrier
24 providing property damage insurance, the policy must contain a joint loss
25 agreement.

26 B. Forms of Insurance Coverage

27 Insurance coverage for an owner's property may be provided by:

- 28 1) Separate individual policies, with coverage added to a policy through
29 endorsements or riders;
- 30 2) Blanket insurance – One or more individual policies, or a master program
31 may provide blanket insurance. Blanket insurance provides one per

- 1 occurrence limit of coverage for all covered properties. Blanket insurance
2 policies may insure multiple properties that may or may not be insured by
3 FHA. The property damage insurance provided by the blanket insurance must
4 comply with the following requirements:
- 5 a) The property insured must be included with a complete street address,
6 including all buildings.
- 7 b) Insurance documentation must show that the limits of the policy are
8 sufficient for the replacement cost value of the properties included in the
9 blanket policy.
- 10 c) The per occurrence limit of the blanket insurance policy is an amount that
11 is no less than the largest single replacement cost exposure covered by
12 the limit of the blanket insurance policy. The greater the number of
13 properties covered by the blanket policy, the lower the percentage of
14 coverage may be in relation to the replacement cost of all assets, as the
15 risk of loss is more widely dispersed.
- 16 d) Properties near each other, or subject to specific perils in the area, (e.g.,
17 hurricanes, earthquakes) should be covered for as much as 90 percent of
18 the aggregate of all buildings' replacement cost¹. Properties that are miles
19 apart may be near if they are in an area that is prone to hurricanes or
20 another peril where the same event could damage multiple properties.
- 21 e) If a blanket insurance policy is used to provide business income/rental
22 value insurance, boiler and machinery, or ordinance and law insurance
23 coverage, the owner should have coverage for no less than the per
24 occurrence percentage determined for the property damage insurance.
25 See 2.3.3A 1)c) above
- 26 f) The maximum per occurrence deductible for a blanket insurance policy or
27 master program providing property damage coverage is the greater of
28 \$50,000, or 1 percent of the aggregate replacement cost of the covered
29 properties, not to exceed \$250,000.
- 30 3) Co-insurance or co-insurance clause

¹ As determined by the lender/servicer using form HUD-92329 or equivalent.

- 1 a) Co-insurance requires the policyholder to carry insurance equal to a
2 specified percentage of the value of property to receive full payment on a
3 loss.²
- 4 b) Fire and Extended Coverage insurance shall be provided and may be
5 either blanket coverage or by specific allocations to individual structures.
- 6 c) Such insurance shall be evidenced by standard Fire and Extended
7 Coverage insurance policy or policies, in amounts not less than necessary
8 to comply with the applicable co-insurance clause percentage, but not less
9 than 80% of the insurable values, or not less than the unpaid balance of
10 an insured mortgage, whichever is less.³
- 11 4) Master program is an insurance program for a group of businesses related
12 through business type, in this case multifamily housing, wherein the coverage
13 terms and conditions apply on a blanket basis to all of the insureds'
14 operations. Master programs are an effective tool for transferring risk,
15 particularly in times when insurance prices are rising. Key components of
16 concern to each owner/agent are:
- 17 a) cost of insurance coverage: premiums, administrative overhead, and
18 claims;
- 19 b) be rated by a rating service, or otherwise meet our creditability
20 requirements
- 21 c) conflict of interest between program administrator and member owners;
- 22 d) accountability: premium allocations, dividend returns, and claims
23 information; and
- 24 e) whether an annual independent audit of the master program was
25 performed, providing analysis of program risk, competitive premiums,
26 number and size of claims, premium allocations among members, and
27 program profits.

² A.M. Best Rating Services, Glossary of Insurance Terms,
<http://www.ambest.com/resource/glossary.html>

³ Form HUD-92447, Property Insurance Requirements,
<https://portal.hud.gov/hudportal/documents/huddoc?id=92447.pdf>

1 Without the proper disclosures of administrative costs, claims costs, and
2 the ability to leave the program if it is no longer the best option for a
3 property, the master program can also become a costly mistake.

4 5) Layered insurance – Involves a series of insurers writing coverage, each one
5 exceeding lower limits written by other carriers. The total coverage of these
6 layers provides the insured owner with a higher total limit of coverage than
7 may have been available from one carrier. The base carrier and at least 50%
8 of subsequent carriers in a layered program must meet the carrier
9 requirements found in Section 2.3.6; or

10 6) Any combination of the policies described above.

11 Regardless of the form of insurance, each policy, endorsement, or rider must
12 show the property's complete address.

13 **2.3.4 INSURANCE THAT MAY BE REQUIRED**

14 Insurance listed in this section may be required at HUD's discretion, and may be
15 specific to individual staffing and property and property features.

16 A. Commercial Umbrella Coverage

17 Commercial umbrella coverage is a supplement to general liability insurance. It
18 provides added protection from gaps or exclusions in commercial general liability
19 insurance. Commercial umbrella coverage has a self-insured retention clause
20 requiring extra coverage for losses the commercial general liability insurance
21 policy does not cover. The most common reason for using commercial umbrella
22 coverage is as a monetary extension for commercial general liability insurance.
23 The owner is required to have a general liability insurance policy to cover primary
24 insurance costs or the umbrella provider may deny the benefits of the umbrella
25 coverage.

26 B. Business Income/Rental Value Insurance

27 Business income/rental value insurance refers to coverage that provides the
28 owner rental income and other business income in the event of a full or partial
29 loss. This insurance also covers normal operating expenses such as utilities that
30 continue during the suspension of rental income. If the primary or other property
31 damage policy does not include business income insurance, the owner must
32 obtain separate insurance for such losses. The policy must include a minimum
33 extended period of coverage for at least 12 months or as much as 18 months.
34 See exhibit 2.3-4 for details.

1 C. Bodily Injury and Personal Property Liability

2 Bodily injury and personal property liability insurance protects a business in case
3 it is sued or held legally liable for injury or loss caused by an error made by the
4 business. The insurer that insures the business at the time of the occurrence is
5 the insurer that handles the claim. The insurer is obligated to work with the
6 business until the claim is resolved, even if the business does not renew the
7 business policy with that insurer.

8 1) Items covered under the liability policy are a function of state law in each
9 state.

10 2) Items not covered generally include:

11 a) injury to a worker. Workers employed by the owner are covered by
12 owner's workers' compensation insurance. Workers employed by the
13 management company are covered by management company's workers'
14 compensation insurance;

15 b) automobile liability; damage or loss caused by a company vehicle is
16 covered by a commercial auto policy sold separately from the liability
17 policy; and/or

18 c) Pollution.

19 3) This insurance should be written with coverage of \$1 million for each
20 occurrence and \$2 million in the aggregate. HUD recommends that a \$3
21 million aggregate limit be purchased when available for a reasonably low
22 additional cost, as determined by the owner.

23 4) HUD will allow a maximum deductible of \$25,000 for projects with <\$100
24 million in total replacement cost, or \$100,000 for properties with >\$100 million
25 in total replacement cost.

26 D. Commercial Auto Policy

27 Commercial auto policy is an insurance policy that covers a company's use of
28 cars, trucks, vans, and other vehicles while carrying out its business. The
29 commercial auto insurance policy may provide coverage for vehicles owned,
30 leased, or hired by the company, or employee-owned vehicles used for business
31 purposes. For projects that operate vehicles owned by the property, the
32 borrower, or the management firm, two major components of an automobile
33 insurance policy involve liability coverage. These components insure the
34 policyholder against injuries caused to another person and damage to property.

- 1) All 50 states and the District of Columbia require minimum liability coverage amounts. These requirements are typically listed as a series of three numbers that define how much, in thousands of dollars, the policy will cover in the event of an accident.
- 2) States set the minimum amounts for bodily injury and property damage liability that insured drivers must maintain. The liability coverage amounts on a policy can be expressed by a series of three numbers, which each represent \$1,000. The numbers correlate to the following: injury to one person per accident, injury to driver/passenger(s) per accident, and property damage.
 - a) Bodily injury liability – The driver who is at fault pays the injured driver/passenger(s) in the other car through their bodily injury liability coverage, up to the policy limit amount.
 - b) Property damage liability – Auto insurance policies also include property damage liability coverage for objects other than automobiles such as fences, light poles, trees, and guard rails.
- 3) Insurance coverage must be, at a minimum, written with coverage of \$1 million for each occurrence and \$2 million in the aggregate. HUD recommends that a \$3 million aggregate limit be purchased when available for a reasonably low additional cost.

E. Flood Insurance

Flood insurance is required, per Section 102(a) of the Flood Disaster Protection Act of 1973 (42 USC 4001), for improved structures located in an area that has been identified by the Federal Emergency Management Agency (FEMA) as an area having special flood hazards, and if the sale of flood insurance has been made available under the National Flood Insurance Program (NFIP). HUD may require flood insurance in amounts beyond that minimum, as stated in the paragraphs below. Flood insurance is property insurance that covers damages caused by flooding, ranging from the need for full replacement to repairs such as replacing flooring and walls. This type of insurance is typically not included in a standard property insurance policy.

- 1) Flooding can cause a great deal of damage. Even if it does not destroy the property, it can fill the property with mud, silt, and other debris, and the moisture from the flooding may lead to rot, mold, mildew, and other problems. Many items may need to be rebuilt or replaced, forcing residents to stay in temporary facilities while their unit is made livable. Flood insurance mitigates these costs.
- 2) FEMA provides for mandatory flood insurance purchase requirements, where floodplain management standards apply. These areas are known as special

1 flood hazard areas (SFHA). HUD only requires flood insurance for improved
2 structures located in the SFHA. For each improved structure located in a
3 SFHA, HUD insurance requirements may go beyond the statutory minimum.
4 HUD requires flood insurance in an amount at least equal to the greater of:

- 5 a) the maximum flood insurance available for that type of property under the
6 NFIP, or
- 7 b) an amount equal to the replacement cost of the bottom two stories above
8 grade.

9 If financial assistance is in the form of a loan or insurance of a mortgage,
10 HUD does not require flood insurance to be maintained beyond the term of
11 the loan or exceed the outstanding principal balance of the loan, even if less
12 than the minimums required above.

13 A lender/servicer is not prohibited from requiring higher amounts of flood
14 insurance.

15 This coverage could require the use of private flood insurance beyond the
16 amounts available under NFIP. Private flood insurance coverage is dictated
17 by the nature of the improved structure and may be adjusted with the
18 concurrence of the lender/servicer, provided that insurance must meet the
19 HUD minimum requirement stated above.

20 3) FEMA determines the floodplains and provides maps of SFHAs, making it
21 possible for surveyors to use a consistent basis for evaluating the property's
22 elevation. This means that the detail found on every flood insurance elevation
23 certificate uses the same basis for the evaluation. Definitions of FEMA flood
24 zone designations can be found in [Exhibit 2.3-1](#) and on the [FEMA](#) website.

25 FEMA has labeled SFHAs as Zone A, Zone AO, Zone AH, Zones A1 through
26 A30, Zone AE, Zone A99, Zone AR, Zone AR/AE, Zone AR/AO, Zone AR/A1
27 through A30, Zone AR/A, Zone V, one VE, and Zones V1 through V30.

28 4) NFIP provides flood insurance across the country for projects that may not be
29 able to obtain it otherwise. Recipients of federal disaster funds after a flood
30 usually must agree to purchase flood insurance as part of the terms of the
31 disaster funds.

32 5) The Biggert-Waters Flood Insurance Reform Act of 2012 requires federally
33 regulated lender/servicers to accept private flood insurance as satisfying the
34 flood insurance coverage requirement if the private flood insurance coverage
35 meets the requirements under the act. For a list of participating insurance
36 providers, see the [FEMA](#) website.

1 6) HUD’s flood insurance requirements will need to comply with the current NFIP
2 standards or any other replacement legislation if they are more restrictive
3 than this handbook.

4 F. Fidelity Bond

5 Fidelity bond refers to insurance in the form of a personal guaranty that protects
6 against loss resulting from disreputable or disloyal employees or other individuals
7 in positions of confidence.

8 1) Moody’s Insurance Dictionary defines fidelity bond as “coverage that
9 guarantees that the insurance company will pay the insured business or
10 individual for money or other property lost because of dishonest acts of its
11 bonded employees, either named or by positions.” The bond covers all
12 dishonest acts, such as larceny, theft, embezzlement, forgery,
13 misappropriation, wrongful abstraction, and/or willful misapplication, whether
14 employees act alone or as a team. Businesses often bond their employees
15 not only because the insurance will pay for the losses, but because the
16 bonding company may prevent losses by uncovering dishonesty in the work
17 history of a new employee.

18 2) Management agents and owners/operators are required to certify that they
19 have obtained fidelity bond or employee dishonesty coverage for all principals
20 of the management entity and all persons who participate directly or indirectly
21 in the management or maintenance of the project or its assets, accounts,
22 and/or records.

23 a) Monitoring compliance with this requirement is the responsibility of the
24 region/satellite office Operations Officer. See HUD [Handbook 4381.5](#), *The*
25 *Management Agent Handbook*.

26 b) Blanket fidelity bond insurance is required in an amount equal to two
27 months’ gross revenues or \$50,000, whichever is greater.

28 c) Owners or management agents with multiple properties subject to these
29 rules must be bonded in an amount equal to two months’ gross revenues
30 from the property with the highest gross revenues or \$50,000, whichever
31 is greater.

32 d) The fidelity bond or coverage must name the owner and HUD as
33 additional loss payees.

34 **2.3.5 ADDITIONAL FORMS OF RECOMMENDED INSURANCE**

35 Individual circumstances of a project may warrant consideration of additional forms of
36 insurance or amounts of coverage for the property in addition to those discussed above.

1 Loan management staff may assist the owner to evaluate the need for optional
2 insurance on a case-by-case basis using the general guidelines of this chapter.

3 A. Ordinance and Law Coverage

4 Both building code standards and the enforcement of those codes have become
5 stricter in recent years. It is likely that the reconstruction of damaged structures
6 may require additional costs to meet current codes. Not only can ordinances
7 and/or laws increase the cost to repair or replace damaged or destroyed
8 property, but also the time to repair or rebuild in accordance with current codes
9 can be extended, which increases business interruption or extra expenses.
10 Ordinance and law is a type of insurance coverage that can be included as an
11 endorsement to an insurance policy. Such coverage pays not only for rebuilding
12 a destroyed project, but for upgrading the property to meet current building
13 codes.

14 Governing documents do not typically require ordinance and law coverage. .
15 Ordinance and law coverage includes three separate types of coverage:

- 16 1) In some jurisdictions, municipal ordinance or code requires that a partially
17 damaged building be demolished. In such cases, a loss to the undamaged
18 portion of the building coverage states that if such ordinance is in place and is
19 enforced by the local authorities, the insurance policy treats the claim as a
20 total loss even though the building was only partially damaged. Coverage
21 should be, at a minimum, equal to the replacement cost of the building.
- 22 2) Increased demolition cost pays for the demolition cost of the undamaged
23 portions of the building if the building, zoning, or land use ordinance or law
24 mandates it. Coverage should be for no less than 10 percent of the project's
25 full replacement cost.
- 26 3) Increased cost of construction pays for any increased expenses incurred to
27 upgrade, repair, or replace the building with components that conform to the
28 current building laws or ordinances. Coverage for increased construction
29 costs should also be for no less than 10 percent of the project's full
30 replacement cost.
- 31 4) Rental income insurance must be provided under ordinance and law
32 coverage to provide for losses that arise from any increased time necessary
33 to repair or rebuild as a result of enforcement of any zoning laws.

34 B. Burglary Insurance

35 Burglary insurance is part of special multi-peril insurance or mercantile open
36 stock burglary insurance that covers against loss as a result of burglary.
37 Coverage extends to loss of merchandise, furniture, equipment, and/or fixtures

1 due to forced or violent entry to the premises. Burglary insurance also covers
2 damage to the building premises as a result of the burglary.

3 C. Builders Risk Insurance

4 Builder's risk insurance is defined as coverage that protects an insurable interest
5 in materials, fixtures, and/or equipment being used in the construction or
6 renovation of a building or structure as well as labor required to rebuild and/or
7 repair the project, should those items sustain physical loss or damage from a
8 covered cause. The coverage limit must accurately reflect the total completed
9 value of the structure, including all materials and labor costs. The construction
10 budget is the best source to determine the appropriate limit of insurance.

11 1) Depending on the terms of the construction contract, either the contractor or
12 the project owner may purchase the builder's risk coverage. In either case, all
13 parties to the project who may have an insurable interest in the construction
14 should be named. The insured party under builder's risk includes not only the
15 contractor(s) who perform the work, but the owner, the lending institution, and
16 others. Suppliers of materials, although having an insurable interest in the
17 property being used in the construction, are not normally candidates for
18 builder's risk insurance, nor are architects or engineers.

19 2) Individuals or companies should not be named as a loss payee, not even a
20 financial institution. When it comes to covering a financial institution's
21 insurable interest, the proper language is "lender" on a separate lender
22 provision; or "designation of lender" on a lender's loss payee endorsement.

23 3) The builders risk policy provides coverage for damage done to the insured
24 structure from a variety of events. Damage from the following events are
25 covered by most policies:

26 a) fire;

27 b) wind (may be limited in coastal areas);

28 c) theft;

29 d) lightning;

30 e) hail;

31 f) explosion;

32 g) vandalism; and

33 h) vehicles/aircraft.

1 A builder's risk policy commonly includes coverage for scaffolding,
2 temporary structures, construction forms, and cribbing.

3 4) The section on exclusions in a builder's risk policy is divided into two parts:

4 a) Causes that directly or indirectly impact the covered property, regardless
5 of any other cause or event that contributes to the loss. A concurrent loss
6 occurs when two independent causes converge on a loss, with one
7 covered and the other excluded. An example of a concurrent loss is
8 damage caused by a landslide (excluded) brought about by negligent
9 construction (covered).

10 Commonly included in this part are losses as a result of ordinance or law,
11 earth movement, nuclear hazard, war or military action, flood or other
12 water source, fungus, civil authority, or contamination.

13 b) Losses from criminal, fraudulent, dishonest or illegal acts, mechanical
14 breakdown, loss of use and consequential losses, wear and tear,
15 voluntary parting, pollution, and/or a steam boiler explosion.

16 Another common exclusion is loss or damage caused by, or because of,
17 design error, faulty workmanship, or defective construction.

18 A consideration in determining the appropriateness of a builder's risk
19 policy is whether an exception for physical loss or damage not otherwise
20 excluded is a part of the policy.

21 5) Standard exclusions include:

22 a) earthquake;

23 b) employee theft;

24 c) water damage;

25 d) weather damage to property in the open;

26 e) war;

27 f) government action;

28 g) contract penalty;

29 h) voluntary parting;

30 i) mechanical breakdown;

- 1 j) coverage for damage resulting from faulty design, planning, workmanship
2 and materials; and
- 3 k) in many cases, the contractor's equipment, other than items mentioned
4 above, is not covered (e.g., bulldozers and ditch diggers).
- 5 6) Of importance in a builder's risk policy is the "when coverage ceases"
6 provision. Unlike other property policies, the builder's risk policy is intended to
7 terminate when the work has been completed and the property is ready for
8 use or occupancy, even though some minor finishing work might remain.
9 Typical termination provisions in the policy are when any of the following
10 initially occur:
- 11 a) The policy expires or is cancelled.
- 12 b) The project is accepted by its owner or purchaser.
- 13 c) The named insured's insurable interest in the covered property ends.
- 14 d) When the named insured abandons construction with no intention to
15 complete it.
- 16 e) Builder's risk insurance policies can often be written in terms of 3 months,
17 6 months, or 12 months. It can often be extended if the project is not
18 completed by the end of the initial policy term, but usually only one time.
- 19 f) Because a precise completion date is often difficult to predict, insurers will
20 generally extend coverage until such a time can be determined.
- 21 g) Some policies also provide that coverage ends 90 days after construction
22 is complete, 60 days after the project has been occupied in whole or in
23 part, or when the property is put to its intended use.
- 24 h) It is important that permanent insurance be arranged and in place so as to
25 ensure a normal transition without a gap in coverage.
- 26 i) In considering policy coverage termination, it is important to note not only
27 what the policy says, but what the construction contract prescribes. If the
28 contract is at odds with the policy, the owner or individual who has the
29 obligation to purchase the builder's risk policy could be confronted with an
30 allegation of failure to procure the appropriate coverage.
- 31 7) Depending on the risk, if the contractor's interests are not covered,
32 contractors might be able to purchase contingent coverage, designed to apply
33 when the party responsible to purchase the builder's risk policy fails to do so,
34 or obtains the coverage but fails to maintain it. If this happens, and a

1 contractor is unable to collect their interest following a covered loss,
2 contingent coverage will apply, subject to the applicable limit and if the loss
3 occurs during construction.

4 8) Coverage on a builder's risk policy should be for no less than 100 percent of
5 the contract(s) and all materials.

6 9) The maximum per occurrence deductible may be \$50,000 for a project with
7 replacement costs up to \$10 million, or \$75,000 for replacement costs of \$10
8 million or more.

9 D. Vacant Dwelling Insurance

10 Vacant dwelling insurance, usually for scattered site projects, is a type of
11 specialty insurance for a dwelling that is vacant. It goes by many other industry
12 names, such as vacant home insurance or vacant homeowner's insurance. The
13 insurance offers protection for dwellings that are unoccupied. Many vacant
14 dwelling policies are offered in 3, 6, 9, and 12 month terms, and usually have
15 minimum limit averages of \$150,000 to \$400,000.

16 Though vacant dwelling insurance varies greatly from company to company, the
17 following is a standard list of what is covered, not covered, and how the dwelling
18 insurance is obtained:

19 1) Vacant dwelling insurance policies offer a replacement cost of the unit, which
20 could vary greatly from purchase price depending on the real estate market at
21 the time the dwelling was purchased versus the market when the vacant
22 dwelling insurance was purchased.

23 2) Homes that may be covered include single family residences, condos, row
24 homes, multifamily homes, apartments, rental properties, and corporate
25 housing.

26 3) Some providers require a home inspection prior to providing vacant dwelling
27 coverage. This can include an assessment of the home's electrical, plumbing,
28 roof, etc.

29 4) Exposure risk when determining price can also factor in location of dwelling
30 and data from the area, including crime rates and vandalism statistics.

31 5) Many companies have minimum limits of their policy but seldom have
32 maximum policy limits.

33 If a property is unoccupied, vacant dwelling insurance can provide the peace
34 of mind that the property is covered.

1 E. Catastrophe Insurance

2 Catastrophe insurance protects properties against natural disasters such as
3 earthquakes, floods and hurricanes, and against man-made disasters such as
4 terrorist attacks. According to the Chartered Property Casualty Underwriter
5 (CPCU) Society, the property casualty insurance underwriter's professional
6 organization, all states in the U.S. are at risk for natural catastrophe losses.
7 These low-probability, high-cost events are generally excluded from standard
8 hazard insurance policies.

9 1) Windstorm insurance – Although most hazard insurance covers windstorm
10 damage, some state insurance companies have removed certain windstorm
11 insurance from standard policies in high-risk areas. Such areas are usually
12 classified as hurricane zones and are in coastal areas. Traditionally,
13 windstorm insurance protects against damage caused by tornadoes and
14 hurricane-strength winds.

15 a) In areas where the risk of windstorms is higher than most, property
16 owners are usually required or encouraged to purchase additional
17 windstorm insurance, which may only be available from a state's wind-
18 pool fund.

19 b) This insurance should be written with coverage equal to 100 percent of the
20 replacement costs without any deduction for depreciation, and either not
21 contain a coinsurance clause, or contain a coinsurance clause that is
22 offset or suspended by an agreed amount provision. If an agreed amount
23 provision is used, it must be equal to the property's replacement costs.

24 2) Earthquake insurance – If a property is in seismic risk zone 3 or 4, and the
25 probable maximum loss (PML) is greater than 20 percent, earthquake
26 insurance should be obtained. For properties being purchased, sold, or
27 developed in a geologic zone where there is a probability for an earthquake,
28 and historically, earthquakes have been documented in the area, a PML
29 Seismic Assessment is likely to have been performed to assess the potential
30 for losses from an earthquake. [Exhibit 2.3-3](#) includes a seismic zone map of
31 the U.S., an example of suggested earthquake insurance, and a template for
32 calculating a suggested insurance amount.

33 a) For properties where earthquake insurance is recommended, the
34 coverage should be the greater of \$1 million or 150 percent of the
35 difference between the projected loss for the improved structure, using the
36 actual PML, and the projected loss assuming a 20 percent PML (see
37 [Exhibit 2.3-3](#)).

38 b) According to the Insurance Information Institute, deductibles for
39 earthquake insurance can range from 2 percent to 20 percent of an

1 improved structure's replacement cost. There is an example at Exhibit
2 23.3-3 of suggested earthquake insurance and a template for calculating a
3 suggested insurance amount.

4 3) Terrorism risk insurance – Under the federal Terrorism Risk Insurance
5 Program Reauthorization Act of 2015' (TRIA) (15 USC 6701 note) enacted
6 after 9/11, an act of terrorism is any violent act, dangerous or damaging to
7 human life, property, or infrastructure within the U.S. or to a U.S. air carrier,
8 vessel, or U.S. mission abroad, committed by an individual or individuals
9 against U.S. civilians or the government. TRIA essentially amounts to a
10 government reinsurance program in the form of a federal backstop.

11 4) In general, TRIA requires that insurers make available coverage for acts of
12 terrorism on the same terms and conditions as other types of coverage
13 offered as part of their commercial property and casualty insurance policies.
14 There are other types of casualty insurance such as cyber liability, identity
15 theft, cyber fraud, interior robbery policy, etc. Standard casualty coverage
16 offered with a business owner's policy is enough casualty coverage and these
17 types of policies are thought to be "flavor of the month," to quote a contributor
18 to www.About.com.

19 F. Directors and Officers (D&O) Liability Insurance

20 D&O liability insurance is generally for nonprofit borrowers. Such policies, when
21 approved by HUD as a project expense, must contain an exclusion stating that
22 the Federal Government does not protect directors and officers from sanctions.

23 1) Although each policy is unique, every policy typically provides coverage to the
24 directors and officers for losses that result from claims made against them for
25 their wrongful acts. The most basic D&O insurance protects directors and
26 officers from liability arising from actions related to their corporate positions.
27 Due to market pressures and the industry's responses to the development of
28 case law, D&O insurance has expanded beyond its original and basic
29 coverage. Individual coverage is typically subject to distinct terms, conditions
30 and deductibles, and may be subject to distinct policy limits.

31 2) The insurer does not pay damages for libel, slander, dishonesty, fraud, or for
32 personal profits illegally received.

33 3) D&O agreements generally specify that coverage is limited to claims first
34 made during the policy period.

35 4) In addition, the insurer typically does not have a duty to defend but is required
36 to cover the costs of the insured's defense.

- 1 5) Many D&O policies offer an optional coverage to protect the corporation
2 against securities claims. Many policies today provide such coverage to the
3 corporation, whether or not its directors and officers are also sued, and other
4 policies provide such coverage only where the corporation is a co-defendant
5 with its directors and officers.
- 6 6) Employment practices liability coverage has become a common addition to
7 corporate coverage. This coverage typically protects directors, officers,
8 employees, and/or the company against employment-related claims brought
9 by employees and, in certain circumstances, specified third parties.
- 10 7) Insurance coverage, when required, must be for not less than \$1,000,000 for
11 each incident, with a maximum deductible amount of \$50,000 for each
12 incident.

13 G. Surety Bond

14 A surety bond is a form of insurance that guarantees contract completion. A
15 performance bond, one type of surety bond, guarantees that the contractor will
16 perform the contract in accordance with its terms and conditions. An owner may
17 seek a contractor to fulfill a contract.

- 18 1) To ensure a successful delivery, the owner may require the contractor to buy
19 a surety bond, and the surety company then becomes responsible for the
20 contractor's obligations. If the contractor defaults, the surety company can
21 either find another principal to fulfill the contract or compensate the owner's
22 financial losses. In other words, the surety ensures a successful contract
23 because it assumes all financial obligations if the principal does not deliver.
- 24 2) Financial management service administers the surety bond program for the
25 U.S. Treasury under 31 U.S.C. 9304-9308 for companies that wish to directly
26 write federal bonds, reinsure federal bonds, or to be recognized as an
27 admitted reinsurer. Find the U.S. Treasury's list of approved sureties on the
28 [U.S. Treasury's](#) website. This is not a rating service.

29 2.3.6 INSURANCE PROVIDERS

30 A. Rating Scales

31 Rating scales are independent opinions regarding the creditworthiness of an
32 issuer. Each insurance carrier that provides insurance for a project must carry
33 acceptable insurance rating categories as specified below in [Exhibit 2.3-2](#). An
34 acceptable insurance rating category is within bands 1, 2, or 3, representing a
35 secure rating.

1 B. Financial Strength Rating

2 A financial strength rating of an insurance carrier applies to the carrier entity itself
3 and assesses the overall claims-paying ability of the insurance carrier. Each
4 insurance carrier should have achieved an acceptable minimum financial
5 strength rating within bands 2 (good or very good), 3 (excellent), or 4
6 (exceptional or superior), as reported by one of the three reporting agencies. See
7 financial strength rating symbols in [Exhibit 2.3-2](#). financial strength ratings for
8 insurers; they are voluntary. While the vast majority of insurers choose to obtain
9 a rating from A.M. Best, only a fraction opt to apply for a second or third rating
10 from Moody's and/or Standard and Poor's (S&P). At this writing, most (76
11 percent) of the insurance companies that are rated have only been rated by A.M.
12 Best.

13 **2.3.7 REVIEWING INSURANCE COVERAGE**

14 A. Throughout the life of the mortgage insurance contract, the lender of an FHA-
15 insured project, or the region/satellite office Operations Officer for a HUD-held
16 project, must ensure that the owner maintains fire and other insurance as
17 required by HUD.

18 1) Lenders, or the region/satellite office Operations Officer for HUD-held
19 projects, usually maintains an expiration date file to ensure that owners renew
20 required insurance policies on a timely basis.

21 2) Copies of the renewal policies for HUD-held projects, or form HUD-2434,
22 Mortgagee's Certificate, must be provided to HUD.

23 3) Reference is made to [HUD Handbook 4350.4](#), *Insured Multifamily Mortgagee*
24 *Servicing and Field Office Handbook*, for additional information about lender's
25 responsibilities regarding insurance requirements.

26 4) The terms of the mortgage insurance require the lender to certify that required
27 insurance is in place. Over time, owner/lender must adjust a project's
28 replacement costs due to changes in construction costs, building codes, other
29 statutory requirements, or other related issues. Lenders for FHA-insured
30 projects, and loan management staff for HUD-held projects must review and
31 update the insurable value figure for the property at least annually as
32 insurance policies renew. This requires maintaining familiarity with changes in
33 costs and other issues in the jurisdiction where the project is located.

34 a) Form HUD-92329, Property Insurance Schedule, completed by the lender,
35 provides the owner the replacement cost values and a description of the
36 property that must be insured by the owner. Loan management staff must
37 review insurance policies for HUD-held projects to ensure that:

- 1 i) the insurable value indicated on the form is up to date and reflects
2 current replacement costs for the property; and
- 3 ii) the amount of coverage included in the policies meets HUD
4 requirements as described above.
- 5 b) Form FHA-2447, Property Insurance Requirements, describes the
6 insurance required by the deed of trust/mortgage, regulatory agreement,
7 or other legal documents and by HUD policy.
- 8 c) Form HUD-2434, executed by the lender, includes a reference to the
9 required insurance and certifies that the insurance has a standard lender
10 clause attached, making all losses payable to the lender and HUD, as
11 their interests may appear.
- 12 **Note:** Association for Cooperative Operations Research and Development
13 (ACORD) is a global, nonprofit standards development organization that
14 serves the insurance industry and related financial services industries.
15 The ACORD 28 form is a document used by the commercial real estate
16 finance industry to serve as evidence of insurance coverage and to detail
17 all the insurance coverage that is in place for a property. Effective 2010,
18 changes to the ACORD 28 form introduce disclaimers indicating that the
19 form is for information only and therefore threaten the form's function of
20 providing proof of insurance. The ACORD 28 form is not an acceptable
21 substitute for form HUD-2434, and form HUD-2434 has not incorporated
22 these changes.
- 23 5) For convenience, [Exhibit 2.3-4](#), Insurance Review Checklist may be used in
24 conjunction with the insurance policy or policies to ensure that all required
25 coverage is provided.

26 **2.3.8 FAILURE TO INSURE**

27 Owners must keep the property insured at all times against hazards, as the lender may
28 require. Insurance must include those types of insurance defined in Section [2.3.3](#), and
29 may include other forms of insurance including, but not limited to, those defined in
30 Sections [2.3.4](#) and [2.3.5](#).

31 A. Notify HUD

32 When an owner is unable to obtain insurance, the lender (or owner of a HUD-
33 held project) must notify HUD within 30 days of the cancellation of the insurance
34 and of the refusal of the insurance company to renew the insurance. For projects
35 with insured loans, the lender prepares a notice of unavailability of insurance and
36 sends it to the Asset Management Division Director or Satellite Coordinator.

1 When a notice of unavailability of insurance is received, the region/Program
2 Center Operations Manager should take the following steps:

- 3 1) ensure that the unavailability is not related to cost; and
4 2) determine if the lender or owner of a HUD-held project is eligible for insurance
5 under the Fair Access to Insurance Requirements (FAIR) plan available in the
6 locality. For information, contact the Insurance Commission for the state in
7 which the project is located, and refer the lender or owner to the FAIR plan, if
8 appropriate.

9 B. Force-Placed Insurance

10 The lender places this type of insurance when an owner's insurance policy
11 lapses or the borrower changes insurance companies and fails to let the lender
12 know about the new coverage. The borrower is responsible for the charges for
13 this insurance. If the lender determines that the borrower has not obtained
14 insurance, or that the owner is not carrying insurance in the required amount, the
15 lender must consider force-placed insurance to protect its security interests in a
16 property. If the property is underinsured, the mortgage lender has the right to
17 purchase lender-placed insurance on the property.

- 18 1) High-risk insurance companies generally provide force-placed insurance, as
19 standard companies are unwilling to provide this coverage because of the
20 high probability of loss. Typically, the premiums for force-placed insurance
21 are higher because the insurance industry believes these properties are at a
22 significantly higher risk of loss if the borrower has not insured the property.
- 23 2) Force-placed policies often provide less protection than less expensive
24 policies available in the open market. If a fire destroys a house, most force-
25 placed policies only pay to repair the structure.
- 26 3) Force-placed policies generally protect the lender's financial interest, not that
27 of owners.
- 28 4) The lender notifies the owner of the obligation to obtain proper insurance
29 within 30 days of the date of the notification.
- 30 a) The notice should indicate what insurance deficiencies exist and provide a
31 date to cure the deficiencies, as well as the next course of action (force-
32 placed insurance).
- 33 b) The notice can be general in terms of endorsements (replacement cost,
34 agreed amount, etc.), or it can be specific to a particular insurance
35 coverage (terrorism, windstorm, flood, etc.).

- 1 c) Any prior correspondence with the borrower and/or the insurance agent
2 should be restated in the notice.
- 3 d) The notice should also reserve any rights and remedies that may be
4 available, depending on the provider.
- 5 5) Some of the required insurance coverage types may not be available from a
6 force-placed company. In addition, the provider may be unwilling to insure
7 some risks, such as workers' compensation or professional liability. If
8 insurance coverage is not available, lenders may consider other alternatives,
9 such as carve-outs⁴, letters of credit (LOC), or may consider the lack of
10 coverage to be an event of default.

11 2.3.9 LOSS SETTLEMENT DRAFTS

12 A. General Requirements

13 When an insurance company receives a claim because of damage or other
14 occurrences, the insurer issues loss settlement drafts as payment of benefits that
15 are due to the insured. Loss settlement drafts are instruments that authorize the
16 transfer of funds from the insurer to the insured. Loss settlement drafts take a
17 variety of forms including a check, an LOC, a letter that authorizes a transfer of
18 funds from one bank account to another or a notice that authorizes a wire
19 transfer of funds.

- 20 1) All loss settlement drafts issued by an insurer must name the owner, the
21 lender (if FHA-insured), and HUD as joint payees.
- 22 2) Owners are ordinarily issued loss settlement drafts. The owner reviews the
23 draft to ensure that it references the required joint payees. If not, the owner
24 returns the loss settlement draft to the insurer with instructions that it be
25 revised and reissued.
- 26 3) Following review of the draft, the owner endorses the draft and forwards it to
27 the lender (if FHA-insured) for endorsement. HUD allows loss proceeds to be
28 expended to restore or repair the property without prior HUD approval
- 29 **Note:** HUD's endorsement may make the loss settlement draft a negotiable
30 instrument. Care must be taken to safeguard the draft properly and to mail it
31 promptly.

⁴ Although older mortgages and Deeds of Trust appear to be silent on the subject, form HUD-94000M provides for remedies for waste in Section 45, and events of default in Section 22(b)(3).

1 B. Restoration of Property Damage

2 The lender and owner are responsible for ensuring that restoration of property
3 damage covered by the loss settlement draft is completed.

4 1) In the case of FHA-insured projects, the lender's endorsement of the loss
5 settlement draft confirms to HUD that the restoration has taken place
6 satisfactorily.

7 2) In the case of HUD-held projects, the Asset Management Division Director
8 must ensure that the restoration has occurred satisfactorily. If the loss is more
9 than \$15,000, a physical inspection of the repairs, documented in writing,
10 must take place before the Asset Management Division Director endorses the
11 loss settlement draft and returns it to the owner.

12 a) If the amount of the loss is large (generally between \$5,000 and \$15,000),
13 in the judgment of the Asset Management Branch Chief, inspections may
14 be scheduled before, during, and/or after restoration work, or during the
15 next scheduled management review or physical inspection of the project.

16 b) If the amount of the loss is less than \$5,000, the repairs are usually
17 inspected during the next scheduled management review or physical
18 inspection.

19 c) Generally, the greater the extent of property damage, the greater the
20 involvement of the Asset Management Division Director in the oversight of
21 restoration work. Consider factors such as the financial and physical
22 conditions of the project. For example, will the financial condition of the
23 project lead to a lower quality restoration in the interests of saving money?
24 Does the age and condition of the building require that current building
25 codes be met during the restoration?

26 d) Some restoration that requires plans and specifications, or a lengthy
27 period for completion, may require multiple inspections. For example, if
28 restoration requires new plumbing or wiring, inspections should take place
29 before enclosing the work with new walls, and before final acceptance of
30 the contractor's work.

31 3) The Asset Management Division Director may require that progress payments
32 of the loss settlement draft be placed in escrow until all loan management
33 inspections are completed and the work is determined to be satisfactory.

1 C. Workout Agreement

2 For HUD-held projects, the Asset Management Division Director must determine
3 that, in addition to satisfactory restoration, the terms of any workout agreement in
4 effect are being met.

5 1) The Asset Management Division Director normally endorses the loss
6 settlement draft and returns it to the owner following completion of
7 procedures.

8 2) If the owner is not meeting the terms of any workout agreement, the Asset
9 Management Division Director should attempt to get the owner's
10 endorsement on the draft, and forward it to the Office of Mortgage Insurance
11 Accounting and Servicing, Headquarters, for application to the mortgage
12 delinquency. If the owner cannot provide the endorsement, the loss
13 settlement draft is returned to the owner without HUD's endorsement.

14 D. Endorsement

15 Loss payee drafts or checks that require HUD's endorsement as one of the
16 payees are endorsed as follows:

17 Pay to the order of [Named owner] without recourse
18 Secretary, United States Department of Housing and Urban Development
19 by:
20 Operations Officer of [Region/Program Center]

21

Exhibit 2.3-1 Definitions of FEMA Flood Zone Designations

Flood zones are geographic areas that FEMA has defined according to varying levels of flood risk.

These zones are depicted on a community's Flood Insurance Rate Map (FIRM) or Flood Hazard Boundary Map. Each zone reflects the severity or type of flooding in the area.

Moderate to Low Risk Areas

In communities that participate in the NFIP, flood insurance is available to all property owners and renters in these zones:

Zone	Description
B and X (shaded)	Area of moderate flood hazard, usually the area between the limits of the 100-year and 500-year floods. B Zones are also used to designate base floodplains of lesser hazards, such as areas protected by levees from 100-year flood, or shallow flooding areas with average depths of less than one foot or drainage areas less than 1 square mile.
C and X (unshaded)	Area of minimal flood hazard, usually depicted on FIRMs as above the 500-year flood level. Zone C may have ponding and local drainage problems that don't warrant a detailed study or designation as base floodplain. Zone X is the area determined to be outside the 500-year flood and protected by levee from 100-year flood.

High Risk Areas

In communities that participate in the NFIP, mandatory flood insurance purchase requirements apply to these zones:

Zone	Description
A	Areas with a 1% annual chance of flooding and a 26% chance of flooding over the life of a 30-year mortgage. Because detailed analyses are not performed for such areas; no depths or base flood elevations are shown within these zones.
AE	The base floodplain where base flood elevations are provided. AE Zones are now used on new format FIRMs instead of A1-A30 Zones.
A1-30	These are known as numbered A Zones (e.g., A7 or A14). This is the base floodplain where the FIRM shows a BFE (old format).

Zone	Description
AH	Areas with a 1% annual chance of shallow flooding, usually in the form of a pond, with an average depth ranging from 1 to 3 feet. These areas have a 26% chance of flooding over the life of a 30-year mortgage. Base flood elevations derived from detailed analyses are shown at selected intervals within these zones.
AO	River or stream flood hazard areas, and areas with a 1% or greater chance of shallow flooding each year, usually in the form of sheet flow, with an average depth ranging from 1 to 3 feet. These areas have a 26% chance of flooding over the life of a 30-year mortgage. Average flood depths derived from detailed analyses are shown within these zones.
AR	Areas with a temporarily increased flood risk due to the building or restoration of a flood control system (such as a levee or a dam). Mandatory flood insurance purchase requirements will apply, but rates will not exceed the rates for unnumbered A zones if the structure is built or restored in compliance with Zone AR floodplain management regulations.
A99	Areas with a 1% annual chance of flooding that will be protected by a Federal flood control system where construction has reached specified legal requirements. No depths or base flood elevations are shown within these zones.

High Risk – Coastal Areas

In communities that participate in the NFIP, mandatory flood insurance purchase requirements apply to these zones:

Zone	Description
V	Coastal areas with a 1% or greater chance of flooding and an additional hazard associated with storm waves. These areas have a 26% chance of flooding over the life of a 30-year mortgage. No base flood elevations are shown within these zones.
VE, V1 – 30	Coastal areas with a 1% or greater chance of flooding and an additional hazard associated with storm waves. These areas have a 26% chance of flooding over the life of a 30-year mortgage. Base flood elevations derived from detailed analyses are shown at selected intervals within these zones.

Undetermined Risk Areas

Zone	Description
D	Areas with possible but undetermined flood hazards. No flood hazard analysis has been conducted. Flood insurance rates are commensurate with the uncertainty of the flood risk.

These definitions may be found on [FEMA's](#) website.

Exhibit 2.3-2 Insurance Rating Scales

Rating Scales Differed¹

Rating Agencies						
Rating	Bands	Weiss ²	Best ^{2,3}	S&P ⁴	Moody's	D&P
Secure	1	A+, A, A-	A++, A+	AAA,	Aaa	AAA
	2	B+, B, B-	A, A-	AA+, AA, AA-	Aa1, Aa2, Aa3	AA+, AA, AA-
	3	C+, C, C-	B++, B+, B, B-	A+, A, A-, BBB+, BBB, BBB-	A1, A2, A3, Baa1, Baa2, Baa3	A+, A, A-, BBB+, BBB, BBB-
Vulnerable	4	D+, D, D-	C++, C+, C, C-	BB+, BB, BB-, B+, B, B-	Ba1, Ba2, Ba3, B1, B2, B3	BB+, BB, BB-, B+, B, B-
	5	E+, E, E-, F	D, E, F	CCC, (CC, C), (D), R	Caa, Ca, C	CCC+, CCC, CCC-,DD

¹ <http://archive.gao.gov/t2pbat2/152669.pdf>

² Weiss and Best use additional symbols to designate that they recognize an insurer's existence but do not provide a rating. These symbols are not included in this table.

³ Best added the A++, B++, and C++ ratings in 1992. In 1994, Best classified its ratings into "secure" and "vulnerable" categories, changed the definition of its "B" and "B-" ratings from "good" to "adequate", and assigned these ratings to the "vulnerable" category. This table contains GAO's assignment of Best's ratings to bands based on our interpretation of their rating descriptions prior to 1994.

⁴ S&P discontinued CCC "+" and "-" signs, CC, C, and D ratings, and added the R rating in 1992.

Insurer Financial Strength Rating Symbols and Rating Distributions⁵

Interpretation ⁶	BCAT4 ⁷	A.M. Best	S&P	Moody's
Superior/Superior/ Exceptional	4	A++, A+	AAA	Aaa
Excellent/ Excellent/ Excellent	3	A, A-	AA+, AA, AA-	Aa1, Aa2, Aa3
Very Good/Good/Good	2	B++, B+	A+, A, A-	A1, A2, A3
Adequate/ Adequate/ Adequate	1	B, B-	BBB+, BBB, BBB-	Baa1, Baa2, Baa3
Uncertain claims- paying ability ⁸	1	C++, C+, C, C-, D	BB+, BB, BB-	Ba1, Ba2, Ba3

⁵ The Journal of Risk and Insurance, 1999, Vol. 66, No. 4, 621-642
 (<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.368.7870&rep=rep1&type=pdf>).

⁶ These are the descriptions used by the three major rating agencies (Best / S&P / Moody's).

⁷ Bands represent rating categories after ratings have been consolidated to four levels. As can be seen, the four levels have corresponding word interpretations across rating agencies.

⁸ The descriptions used by the rating agencies are more difficult to compare below the "adequate" level. All insurers rated by more than one of the rating agencies had Best's ratings of very good (B++, B+) or higher, except for one company rated by both Best and Moody's. Consequently, grouping all ratings below adequate into one category only affects the rating difference for one firm.

Exhibit 2.3-3 Earthquake Seismic Scales

For a comprehensive discussion of seismic hazards, see [MAP Guide](#) Appendix 5.C. “Seismic Resistance and Fire Protection Standards for Existing Buildings”, and follow a [link](#) to the U.S. Geologic Survey.

Earthquake Insurance Suggestions – (Example)		
Replacement Cost	12,000,000	12,000,000
Probable Maximum Loss	30%	3,600,000
Probable Maximum Loss at 20%	20%	2,400,000
Difference		1,200,000
Difference X 150%	150%	1,800,000
Recommended Insurance		1,800,000

Exhibit 2.3-4 Insurance Review Checklist

Type	Does Coverage Meet Requirements	Minimum Insurance	Maximum Deductible	Y/N/NA		
				Yes	No	
Fire and Extended	At least 80% of current replacement costs with coinsurance	100% of replacement cost	< \$10 million - \$50,000 ≥ \$10 million - \$75,000	Yes	No	
Comprehensive General Liability	At least the minimum per occurrence and annual aggregate amounts	See Section 2.3.3.A.4		Yes	No	
Workers' Compensation	Insurance to pay lost wages and medical expenses	All employees who are not owners must be covered		Yes	No	
Boiler and Machinery	Coverage against the breakdown of boilers, machinery, and electrical equipment.	100% of replacement cost, plus replacement cost of covered equipment	< \$10 million - \$50,000 ≥ \$10 million - \$75,000	Yes	No	
Business Income/Rental Value	Coverage against loss of profits and continuing fixed expenses	≥ 5 stories – 18-month gross anticipated income < 5 stories – 12 month	Waiting period < 72 hours	Yes	No	
Commercial Umbrella	A monetary extension for commercial general liability insurance	Sufficient to achieve 100% of replacement cost		Yes	No	N/A

Type	Does Coverage Meet Requirements	Minimum Insurance	Maximum Deductible	Y/N/NA		
				Yes	No	N/A
Business Automobile	Covers a company's use of cars, trucks, vans and other vehicles	\$1 million each occurrence, \$2 million aggregate.		Yes	No	N/A
Flood Insurance	Property located in FEMA Special Flood Hazard Area	maximum available under the NFIP, or the replacement cost two stories above grade. See Section 2.3.4.E.6	< \$10 million - \$50,000 ≥ \$10 million - \$75,000	Yes	No	N/A
Fidelity Bond	Employee dishonesty coverage for all principals	Greater of two months of gross revenues or \$50,000		Yes	No	N/A
Directors and Officers Liability	Employee dishonesty coverage for all principals	Not less than \$1,000,000	Maximum \$50,000 per incident	Yes	No	N/A
Ordinance and Law Coverage	Pays for upgrading the property to meet current building codes	No less than 10% of replacement cost		Yes	No	N/A
Burglary Insurance	Covers loss as a result of burglary; covers damage to the premises as a result of burglary	Greater of two months of gross revenues or \$50,000		Yes	No	N/A

Type	Does Coverage Meet Requirements	Minimum Insurance	Maximum Deductible	Y/N/NA		
				Yes	No	N/A
Builders Risk Insurance	Covers an insurable interest in materials, fixtures and/or equipment	Must reflect the completed value of the structure, including materials and labor costs	< \$5 million – \$50,000 ≥ \$5 million – \$75,000 per occurrence	Yes	No	N/A
Vacant Dwelling Insurance	Specialty insurance for a dwelling that is vacant	Minimum limit averages \$150,000 to \$400,000	< \$5 million - \$50,000 ≥ \$5 million - \$75,000	Yes	No	N/A
Windstorm Insurance	Protects against damage caused by tornadoes and hurricane-strength winds	100% of replacement cost	< \$5 million - \$50,000 ≥ \$5 million - \$75,000	Yes	No	N/A
Earthquake Insurance	Located in a Seismic Risk Zone 3 or 4, and Probable Maximum Loss greater than 20%	See Exhibit 2.3-3	2% to 20% of replacement cost	Yes	No	N/A
Terrorism Risk Insurance	Any violent act dangerous or damaging to human life and property	100% of replacement cost	< \$5 million - \$50,000 ≥ \$5 million - \$75,000	Yes	No	N/A

This chapter incorporates guidance in the form of memoranda, notices, and other forms of directives applicable to insurance and loss drafts for projects published since the previous publication of the Project Monitoring chapter in September 1992.

Disposition of Fire and Hazard Insurance Proceeds	FR Volume 59, Number 116 (Friday, June 17, 1994)
Loans in Areas Having Special Flood Hazards	Biggert-Waters Flood Insurance Reform Act of 2012
Directors and Officers Liability Insurance	H 92-76
Disposition of Hazard Insurance Proceeds	H 92-86
Disposition of Fire and Hazard Insurance Proceeds	ML 94-38
Final Rule - Disposition of Fire and Hazard Insurance Proceeds	Federal Register / Vol. 59, No. 116 / Friday, June 17, 1994