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## PRACTICE GROUP: REAL ESTATE

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### INSURANCE ISSUES CAN ARISE WHEN CONVERTING APARTMENTS TO RESIDENTIAL CONDOS

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Since 2009, we have seen a significant uptick in the number of new apartments under construction in the Northwest, especially in the urban downtown cores. There has been dialog and speculation over time about whether owners will start to convert some of these properties from apartments to condominiums.

This is not unprecedented; it has happened before in previous real estate cycles. As we see this conversation happening more frequently, we wanted to offer some advice on the potential issues associated with condominium conversions from an insurance perspective.

**...you have to understand the involved parties' insurance coverage during the construction of the original project, after the original project is completed, and during the conversion.**

Typically, when building commercial apartments in Seattle, the owner has relied on the contractual transfer of risk to the general contractor and subcontractors. At the time of construction, the general contractor and subcontractors presumably all carry adequate insurance

coverage with no residential construction exclusions. They are, in general, contractually required to carry this coverage through the statute of repose (six years for the state of Washington).

If the owner retains the property and operates it as apartments beyond the statute of repose, then sells the property and the new owner converts the building to condominiums, then, in the eyes of the law and thus the insurance carriers, this likely would be considered a new project. The owner converting the building would need to purchase appropriate coverage for the conversion project. Any resultant defects would then be covered under the new policy, and the original owner and contractor would no longer be liable for construction defect claims, as the statute of repose on the original construction would have run out.

However, assume that the owner decided to convert the project to condominiums three years after the certificate of occupancy was granted, both the owner and general contractor could be involved in construction defect claims. These would arise from the new condominium owners, alleging defect(s) in the original

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construction and/or conversion construction work. Therefore, a potential dilemma arises; whose insurance policy will respond to the claims?

In order to answer that question, you have to understand the involved parties' insurance coverage during the construction of the original project, after the original project is completed, and during the conversion. During the original construction, it will be important to know if any of the contractors or subcontractors had policies excluding residential work, and how residential work is defined in the respective insurance contracts. There are all different flavors of residential exclusions.

A second consideration is whether the policies include exclusions for condominium conversions. These endorsements are being added to both owners' liability policies and contractors' liability policies more frequently. These endorsements negate coverage for construction defect claims that arise during or after the conversion phase.

In order to avoid these situations, there are insurance products available to cover the owner and contractors during construction and post-construction through the appropriate statute of repose. When purchasing this coverage, it is important to think about all possible transitions that might happen over the next 10 years and how owners will protect themselves. How will the general contractor protect itself?

Discuss with your insurance professional teams the best option for today and potential future risks, and whether you will address them contractually or with insurance. In addition, you will want to consult your legal team as there are potential legal challenges to be overcome as well.

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