

When the House Burns Down . . .

While attending Stetson's National Conference on Special Needs Planning and Special Needs Trusts in 2023, I learned that real property owned by a first party special needs trust that we as corporate trustee administered had suffered total loss in a fire, along with its contents. The real property was the home of the beneficiary and his parents, who are his guardians, and other family members, one of whom is also disabled. Thankfully, no one was hurt! But the journey of navigating the insurance claim, temporary living arrangements for the beneficiary and his family, and "allowable disbursements" as per Arizona's Medicaid program, the Arizona Health Care Cost Containment System (AHCCCS), had begun. Much was learned in this process that I thought would be helpful to share with my fellow fiduciaries and attorneys who represent them.

The obvious first order of business was to submit the claim. We had recently switched from individual insurance policies to a master insurance policy, which had many advantages, some of which are as follows:

- Broad named insured to include the fiduciary and not just the beneficiary, protecting our institution as fiduciary;
- Generally competitive premium but with broader coverage;
- Guaranteed Replacement Cost v. Scheduled Replacement Cost;
- Significantly more substantial liability limits per occurrence/per location and in aggregate;
- Lower deductible;
- Broader sub-limited coverages including valuable articles, fine arts, business income, farm equipment, crops in storage, livestock, etc.; and
- Earthquake and Flood included rather than separate policies require.

Top priority was to provide alternative living arrangements for the beneficiary and their family. The master insurance policy provided for an amount under Loss of Use to be applied toward these expenses. The insurer contracted with a third party to facilitate the arrangements and payment for these expenses. Initially, that was a hotel stay immediately following the loss followed by a long-term rental to accommodate the beneficiary's need for accessibility and the family who are his caregivers. Typically, the claim for Loss of Use would be paid to the insured, which was the special needs trust. However, I was concerned with the special needs trust being able to pay the cost of the long-term rental for not only the beneficiary, but his family who were also displaced. As such, I ran interference immediately with the adjuster and asked that this portion of the claim be paid to the third-party contractor who, in turn, would pay the rental expense directly to the landlord. Thankfully, the adjuster understood and appreciated the issue and made this accommodation so as to avoid implications with the special needs trust and the beneficiary's eligibility for SSI and Medicaid or, alternatively, burdening the family with a pro rata share of the rental cost.

Next order of business was to plan for the reconstruction of the property. The insurer contracted with a construction consultant to develop a repair estimate to reconstruct the home and with another third party to prepare an estimate for replacement of the personal property contained in the home that was also destroyed. The construction consultant identified a contractor to construct the home with whom it and the insurer had previously worked so it was accustomed to

working within the parameters of the claim. Upon agreement on the repair or, rather, construction cost by the contractor and insurer, the contractor prepared a contract for us, as trustee, to execute, which set forth the total cost and when payments (3) were due as construction reached certain benchmarks.

I learned about the loss amount and its depreciation to arrive at the actual cash value. The actual cash value is what was to initially be paid to the insured, the special needs trust and, upon near completion, the depreciation amount would be paid, which coincided with when the final installment payment of the construction contract was due. The objective in not paying the total loss amount of the claim up front so as to avoid a windfall to the insured should the insured opt not to reconstruct the property. As trustee, we presented the option to the beneficiary's legal guardian. Why did we present the option to the beneficiary's legal guardian? The special needs trust had limited liquidity and it was an opportunity to add to that and prolong the life of the trust. Additionally, we expressed our concern about subjecting the home to the Medicaid payback upon the death of the beneficiary, whose life expectancy is diminished due to their condition. We explored with the parents, both of whom are employed, the opportunity and ability to purchase their own home. In the end, the parents/guardians decided to proceed with the reconstruction of the home.

Following the decision to proceed with the reconstruction, arrangements were made for the initial payment of the actual cash value amount to the special needs trust. We then turned our immediate attention to notifying our Medicaid agency about the destruction of the real property in a fire, the insurance claim, and anticipated disbursements from the special needs trust to the construction company pursuant to contract. In Arizona, anticipated disbursements must be approved by our Medicaid agency in advance. I provided Medicaid the Statement of Loss and explained what was being paid now, the actual cash value, and what would be paid later near completion of the construction, the depreciation amount, as well as the deductible the trust was required to pay, providing supporting documentation for these amounts. Medicaid approved the disbursements of the insurance proceeds received for construction of the home pursuant to contract, after which we signed the construction contract and made initial payment.

As you can imagine, the construction revealed additional costs that were negotiated between the contractor and insurer. As a result, additional funds were paid out to the special need needs trust to cover the additional costs. The adjuster assured us that additional costs would be covered given the substantial aggregate liability coverage available under the master policy. That would not have been the case with an individual insurance policy. Like most construction projects, as we neared the forecasted completion of twelve (12) months, we were advised that the construction would likely not be completed for another several months due to delays with permits, etc. The beneficiary and their family's lease was terminating at twelve (12) months. Fortunately, the third-party contractor was able to negotiate an extension of three (3) months at the same rate and just enough funds remained under Loss of Use coverage to cover the extension without the family having to be out-of-pocket their pro rata share.

As we neared the end of the construction and it came time to paint the exterior, we were required to submit the proposed paint and roof scheme to the Homeowner's Association (HOA) for consideration and approval. We had requested information from the HOA about approved

colors and materials in advance and obtained input from the parents/guardians regarding their preference. Fortunately, the HOA promptly approved the request. As an aside, during the construction, a violation notice was received from the HOA regarding the landscaping for which we sought a waiver for the duration of the construction and which was also approved. Recently, we received a violation notice regarding the paint of the exterior wall, which may have been overlooked, and are addressing that. Interestingly, the approved paint scheme has changed since the house itself was painted.

Now it was time to turn our attention to furnishing the home. As was the case with the determination of the value of the structure—actual and depreciated—a third party consultant was hired by the insurer to do the same with respect to the contents of the home or personal property. The actual cash value was initially paid to the special needs trust with the option to seek additional reimbursement of the replacement costs if it exceeded the actual cash value up to a certain amount. In this instance, it was not necessary to seek the reimbursement of the replacement cost beyond the actual cash value.

Unfortunately, the personal property was purchased by the parents, not the beneficiary nor his special needs trust, but the insured was the trust and, as such, the claim could only be paid to the trust. The master policy provided up to \$50,000 in coverage for the personal effects and property of others but that, too, had to be paid to the special needs trust. We had to again seek Medicaid's approval to disburse funds to purchase personal property and, while I was at it, I made the case to Medicaid to disburse \$50,000 to the parents as provided for in the master policy for them to replace their own personal property and personal effects. Surprisingly, Medicaid approved all disbursements!

The logistics were challenging. We had a True Link account/card and relied upon and utilized that for the parents/guardians to purchase items. We did not want to fund the entirety of the insurance proceeds for replacement of personal property to the account/card and instead, did so in increments of \$20,000. We promptly learned that we could only fund the account/card \$5,000/day for a total of \$20,000 per month. True Link worked with us initially and provided a loan to the account so that the initial \$20,000 was immediately available, which was paid off with the subsequent funding of \$5,000/day. Timing was crucial as the beneficiary and their family had no place to store personal property while in the rental (which included rental furniture) but needed to have the bare essentials, such as beds, upon moving into the newly constructed home.

All were thrilled when the beneficiary and their family were able to return to their "new" home. Our experience with the insurer and its adjuster, as well as the contractor, was positive. And, surprisingly, Medicaid appeared sympathetic to the situation and approved what was requested based on the original submissions. Note, I spent a great deal of time preparing the submissions with supporting documentation, which served us well.

P.S. It's been more than a year and a half since this has concluded. We are now learning a hard lesson in that the insurer of our master policy is terminating our coverage and the only other insurer who will entertain providing us a comparable master policy has quoted a premium increase of about 25%, which is not affordable as we allocate this expense to our fiduciary accounts that hold real estate covered by the policy. We are now shopping for individual policies and my concern

is whether anyone will be willing to insure this home and, if so, at what expense. Moral of the story, vet the real estate that is coming in for insurance purposes, i.e., condition of the home, age and history of claims and repairs, location and exposure to risks, residents of the home and their activity, etc. and selectively add real estate to a master policy, while sticking with an individual policy for those properties that have the potential of impacting continued coverage under a master policy and cost.