Building Ordinance Coverage

The Older the Building, the More Important the Coverage

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By Tim Cline, CIRMS, Timothy Cline Insurance Agency, Inc., Santa Monica, CA

Is your building older, or subject to significant code changes if the project were to be rebuilt? This article explains how Building Ordinance can help protect your property.

All insurance policies have been written based on the concept of "indemnity". Indemnity means "protection or security against damage or loss". In this vein, fire insurance policies were never designed to put a person in a better position than he/she was prior to a loss, otherwise the existence of insurance might inadvertently create an incentive to have a loss.

To say that insurance companies are a little uncomfortable with the idea of someone profiting from having a loss would be a gross understatement. To prevent a policyholder from unfair compensation whenever a covered loss occurs, most insurance contracts are written in such a way that the carrier's only responsibility is to return the building to the condition it was prior to the loss. This is true even if an older building is damaged and substantial changes in the building codes have occurred requiring considerable updating or improvements. Such consequential losses that occur as a result of the enforcement of the building code, will not be covered under the standard fire insurance policy.

The building codes can pose a threat even if there is a partial loss. Unfortunately, most municipalities require that if 50% or more of the building is damaged that the entire structure (damaged and undamaged portions) must be brought up to current building codes. If there has been a change in the building codes since original construction, the cost for those additional improvements must be paid solely by the Insured.

Changes in building codes can be "slight"... the building code requires the installation of hard wired smoke detectors; to "moderate"... the building code now requires that the building must be retrofitted for fire sprinklers; to "severe"... when the building code now requires residential fire sprinklers (Cost: $15,000 per unit or more).

If your building was converted from an apartment project or is more than fifteen years old, the building code changes might be substantial. It's best to consult with your community's Department of Building and Safety to determine what changes might be necessary if your building must be brought up to current building codes.

An optional insurance coverage called **Building Ordinance** is offered. This protects the Association against consequent loss resulting from the enforcement of laws or ordinances which do not permit restoring a building to its condition prior to loss. Such coverage is required by many Covenants, Conditions and Restrictions, yet only a few of the condominium associations currently maintain the coverage. The coverage is specifically designed to protect the Association against losses sustained as a result of the enforcement of building codes or ordinances.

Building Ordinance coverage is comprised of three separate parts or coverages:

- **Demolition Coverage**: Since the undamaged portion might need to be demolished in order to rebuild a structure that conforms to current building code, Demolition Coverage covers the cost of demolition of the undamaged portions of the building in order for the entire building to be replaced with one conforming to present building codes.

- **Loss of Value:** Because the undamaged portion was not technically "damaged", the regular fire policy would not cover the "loss" of the undamaged portion of the structure. This coverage picks up the Loss Of Value of an undamaged portion of the building (this portion of the policy is designed to cover the costs to rebuild the undamaged portion).

- **Increased Cost of Construction**: This covers the increased expenses incurred in replacing the building with one conforming to laws or ordinances or to repair the damaged building so that it meets current building laws or ordinances. In our example, it would cover both the cost to bring the damaged and the undamaged portion up to current building code).

In order to receive a quote from your insurance agent or broker for this very important coverage, you'll need to address two items... (1) How much demolition coverage would be necessary to demolish the undamaged portions of the project (most demolition costs are approximately $2.00 per square foot), (2) How much Increased Costs Coverage will the Association need (how much will it cost to bring the entire building up to current building codes).

One pitfall... Some condominium projects are located in areas where down zoning has occurred. An example of down zoning is when a 30 unit condominium project is built on a piece of land that, since construction, has been designated by the local Land Use Planning and Zoning Department to only hold 20 units. If a loss occurs that affects more than 50% of the structure, the Association may only be able to rebuild twenty units, not the original thirty units. In this case, the "loss" was not resulting from the enforcement of laws or ordinances pertaining to the building, but rather pertaining to the land. It is the land that has sustained the loss (i.e.: any real estate developer knows that a piece of land that supports 30 units is substantially more valuable than a piece of land that only supports 20 units), thus, the down zoning is not insurable.

If your project is on a piece of land that has been down zoned, it's important that the Board not only disclose this to the current owners but also to any prospective owner that may show an interest in the building. It is also important to note that the municipalities "overlooked" a down zoning situation on one of the condominium associations that were devastated by the San Francisco earthquake of October 17, 1989 and the Northridge Earthquake of January 17, 1994. In each case, the Department of Building and Safety permitted <u>all</u> of the units to be rebuilt - even though the site had been down zoned. This is not to say that every community will overlook their zoning ordinances when a loss of this type occurs, but it is encouraging nonetheless.

About the Author: Tim Cline, CIRMS, is President of Timothy Cline Insurance Agency, Inc. of Santa Monica. Tim is a past President of the Greater Los Angeles Chapter of Community Associations Institute, a former Chair of the CAI National Insurance and Risk Manager Professionals Networking Committee and currently on the Board of Directors of the Los Angeles Chapter of the Insurance Brokers and Agents Association of the West.

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“Insurers of Condominium Associations throughout the West”
www.timothycline.com