Why Ordinance of Law Coverage is Needed, written by Bat Koszinowski, CIC, CIRMS, November, 2010

- Grandfathering is an important tool in passing laws to improve the quality of new construction because it exempts existing structures and does not require them to comply with new laws and ordinances. Imagine the cost and complications we would have if existing buildings had to be upgraded each time a new code or ordinance was introduced.
The laws permitting grandfathering also specify when and under what circumstances an exemption ends. In many cases, an existing building must comply with new codes and ordinances when it undergoes a major renovation or after a significant property loss. In many cases a typical provision may require that the entire structure not currently complying with the code must be brought up to code if it is damaged to the extent of 50% or more. One of the biggest reasons for this is that it would not make sense to combine an old and outdated structure that is out of code with a new structure.

What does insurance have to do with this?
Insurance policies are contracts of indemnity. This means they return the insured to the condition that existed before the loss occurred and nothing more. They are not intended to improve the insured's situation. Compliance with new codes and ordinances creates a betterment of the insured. Most insurance policies and coverage forms do not provide for or include the cost of such improvements. Even the replacement cost valuation provision states that any changes required due to the existence of an ordinance or law are not covered.

Example: ABC Apartments, a three story frame-type complex, was built in 1964. Over the years, the city and county passed new building codes but ABC Apartments was grandfathered when new zoning laws were enacted. A severe fire destroys 75% of the ABC property. When ABC contacts the city and attempts to obtain building permits, ABC is informed that the apartment cannot be re-built because it violates current zoning requirements and does not meet new building codes. Because the building is only 75% damaged the insurance company only pays for this portion of the claim. Due to the ordinance or law exclusion in the insurance policy the insurance company does not have to pay for the demolition of the condemned remainder of the building as well as the debris removal. ABC Apartments is also faced with expenses related to increased cost of construction due to building code changes. Again the insurance company would not have to pay for this expense under a standard insurance policy.
ABC Apartments faces a severe shortage of insurance proceeds.

How can you protect your HOA from this?
The older the property and/or recent major code changes make ordinance or law insurance an important factor in evaluating your HOA's insurance needs.

In some cases the CC&R's in the insurance section may stipulate some ordinance or law coverage requirements. Many experts and drafters of CC&R's also consider verbiage that would state customary comprehensive property insurance to include ordinance or law coverage.

Ordinance Or Law Coverage Endorsements
There are three different types of endorsements that are available:

- **Coverage A** provides for loss to the undamaged portion of the building. It covers the loss of value of the undamaged portion of the building that must be destroyed due to the building code or ordinance imposed following a covered loss.
- **Coverage B** provides for the cost to demolish and remove the undamaged portions of the building but only if the destruction is due to the building code or ordinance imposed following a covered loss. Important fact: expenses to transport and dispose of potentially contaminated debris can be costly.
- **Coverage C** provides for the increased costs to repair or rebuild the property to comply with current building, zoning or land use ordinances or laws. The increased costs must be due to the building code or ordinance imposed following a covered loss.

HOW DOES IT WORK?

Coverage A–Loss To The Undamaged Portion Of The Building

Property insurance usually applies only to damaged property. This coverage does just the opposite and provides coverage for undamaged property. This coverage applies to the undamaged portions that must be destroyed because of a law or ordinance that controls construction.

Example: Beehive Department Store is a five-story, joisted masonry building in the downtown area. A city ordinance requires that all buildings two stories or higher be of masonry noncombustible or better construction. Grandfathered buildings must conform to this ordinance if they sustain damage to the extent of 30% or more. A fire destroys 40% of the building. Beehive is informed of the ordinance and told that it cannot rebuild the structure as is. In addition, it must demolish and remove the remaining 60% because it does not meet current construction requirements. **Coverage A applies to the undamaged 60% of the building.**

Coverage B–Demolition Cost Coverage

Providing coverage on the undamaged portion of a building is not enough. In order to rebuild the structure, the undamaged portion must be removed and the site cleared to allow for new construction and debris needs to be properly disposed. This coverage allows the insured to anticipate the expense of demolishing an older structure. This requires a separate limit of insurance. This limit should be selected carefully and after much thought and review because of the high costs of demolition. The actual costs of demolition and site clearance are covered up to the limit of insurance indicated on the schedule.

Example: Beehive Department Store must demolish the undamaged building in order to bring the entire structure up to code. The anticipated cost to demolish and remove debris is $ 150,000. Beehive had purchased $ 250,000 of Coverage B insurance and the insurance company paid the expenses for this portion of the claim.

Coverage C–Increased Cost Of Construction

This coverage is important for any company subject to the Americans with Disabilities Act (ADA) or any of a number of similar or related local, state and federal ordinances affecting construction, reconstruction, repairs, remodeling and renovations after a loss. Many of these ordinances and codes are helpful with the cost of compliance being relatively inexpensive and easily accommodated in new construction. However, similar compliance in an existing building or structure following a loss is considerably more expensive and difficult to accomplish. In addition, these costs are not included and covered under most insurance policies and coverage forms.

Example: Utah Capitol HOA has served its owners for decades. The building is masonry construction with plaster walls. The hallways in certain areas are rather narrow but open to spacious open areas. A fire that starts in a kitchen damages the kitchen, some of the living areas and several other rooms. When building permits are obtained to repair the damage, Utah Capitol HOA is told that the hallways must be widened to meet ADA standards.

Coverage C pays the increased costs to repair the damaged portions of the building up to the minimum requirements of the ordinances and laws. It also pays the costs to remodel or even rebuild the undamaged portions of the building to bring them into compliance with the minimum requirements of the ordinance or law. The buildings do not have to be demolished before this is implemented.

This coverage applies only if the building is actually repaired, remodeled or rebuilt for the same or a similar occupancy. The occupancy can be changed only if the law or ordinance requires an occupancy change due to current land use or zoning restrictions.

Questions or comments please email beatk@buckner.com or call my cell at 801-577-9455.
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and state regulations.