A Guide to Helping Your Clients Understand **Building Ordinance Coverage**

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Building Ordinance Overview

Building Ordinance coverage is sometimes overlooked, but is a very important coverage for your clients to consider. This guide is designed to provide you with a general overview of Building Ordinance coverage so you can help your clients understand why they should consider having this valuable coverage.

It is important to understand the definition of Building Ordinance as it relates to loss to the undamaged portion of a building which has incurred a loss.

Standard property forms provide coverage for the indemnification of the actual physical structure and returning the building to the condition it was prior to the loss from a covered peril.

What is not covered under the property coverage form, and is specifically excluded, is the increased cost of rebuilding, repair or remodeling created by the application of local, state and federal building codes.

Building Ordinance coverage, or also termed Ordinance or Law coverage, was developed to fill the gaps created by these exclusions.

The property business income coverage form also excludes coverage applicable to building ordinance, thus if there is delay in the construction due to building ordinance application, loss of income during this period of restoration is not covered.

Building Ordinance – Increased Period of Restoration coverage was created to cover this area.

A Practical Understanding

When a building or structure is built it has to meet all current building codes. A building that was built to code at one time may not be in compliance at a later date. The time from being compliant, at the construction date, to being out of compliance can vary from six months to several years depending on the frequency and nature of changes in ordinances or laws.

The ordinance and requirements can originate from many sources: local, state or federal. A common example of a Federal construction code is the American with Disabilities Act (ADA), requiring building owners to build with the proper additions to aid disabled people. However, most of the emphasis is on local codes as the local jurisdictions are charged with enforcing the building codes.

Most building code standards are developed by advisory organizations. These standards are quite numerous (over 93,000) and apply to all aspects of construction and building materials.

Examples of advisory organizations are:

- The National Fire Protection Association (NFPA) which maintains advisory codes related to fire protection.
- The National Earthquake Hazard Reduction Program (NEHRP) which maintains codes detailing building methods designed to protect against earthquake in specific seismic zones.

ABCs of Building Ordinance Coverage

Coverage A: Coverage for Loss to the Undamaged Portion of a Building

This coverage responds when a covered loss triggers the application of ordinance or law, but only a portion of the building is damaged. If the undamaged portion of the building is rendered as unusable, or condemned, by an ordinance then it would have to be torn down, thus a total loss of the building would be incurred.

This coverage would indemnify the insured for the undamaged portion even though there was not direct peril damage to the building. The maximum limit that can be chosen is the total limit scheduled in the property policy.

As this coverage directly relates to insuring the building at proper values when replacement cost is written, it is paramount that the insured be encouraged to request limits for a building at 100% of the replacement cost value. This coverage is subject to the application of coinsurance when written under the standard property policy with a coinsurance provision.

Coverage B: Coverage for the Cost of Demolition

This coverage pays the cost to demolish the undamaged portion of the partially damaged building (the property coverage responds to demolition and debris removal of the damaged portion of the building).

It is often misunderstood as to the value or limit that should be covered under this area. The coverage is dependant on several variables, such as:

- Local construction costs for demolition
- Amount of the undamaged portion of the building
- Special hazard issues, such as asbestos insulation

A generic estimate can be from 2 to 5 times the square footage of the worst case scenario (approximately 50% of the structure). Many times this can just be an "educated guess" since there is not a fixed limit for this coverage and coinsurance does not apply.

Coverage C: Coverage for the Increased Costs of Construction

This coverage includes the recovery of costs related to making the building compliant with current building codes. When setting limits, this coverage tends to be the most misunderstood of the three.
As this coverage is excluded under the standard property policy, the insured may not be insuring to a true replacement cost value without adding this coverage. There is no exact formula to determine the proper limit, but the more informed the insured and the agent are as to the status of the structure being "out of code" the better the determination of an adequate limit. In addition, this coverage is not subject to a coinsurance penalty.

Increased Period of Restoration: Coverage for delay due to application of laws

At times, there can be delays in repairing or replacing the undamaged portion of a building. This coverage lengthens the period of restoration as it relates to business income coverage.

The "period of restoration" as defined in Business Income coverage is the time after a loss during which business income and extra expense losses are paid. This period begins after a number of hours and ends on the date when the property should be repaired, rebuilt or replaced.

This period does not include any "increased period" that is necessary due to enforcement of an ordinance or law that could require a portion of the damaged building to be torn down, or the construction of the repaired or replaced building to meet the current building codes.

The Increased Period of Restoration endorsement then extends the business income and extra expense coverage to include additional time needed to restore operations when delayed due to enforcement of building or zoning laws. It is important to note that this endorsement does not include a delay, or loss, that involves enforcement of ordinance or law which requires a building owner to clean up, treat or remove pollutants.

When selecting this optional coverage, it is necessary to adjust the amount, or limits, of business income coverage to reflect the extended period of indemnity.

What Triggers Building Ordinance Coverage

It is very important to understand what triggers Building Ordinance coverage. This coverage responds only if the following occurs:

1. The loss is caused by a covered peril.
2. The loss breaches the "major damage" threshold as defined by the jurisdiction.

   "Major damage" is the term referring to a situation where the local jurisdiction considers the building beyond safe repair due to age, condition or previous compliance with building code. At this point, the jurisdiction would require the entire structure to be brought into compliance with current codes.

   Jurisdictions normally use state law to decide when this point of major damage has been breached and it can vary by jurisdiction from as low as 30% of the building value to as high as 60%. The most common percentage used is from 50% to 60% of the value.

3. The damaged building must be lacking in, or deficient of, some aspect of local building codes in effect at the time of the loss.

Building Ordinance Form

It is important to review the Building Ordinance form. There are exclusions built into this coverage part, such as loss of value to the property, pollution related loss and more.

Current Replacement Cost Value

Indemnifying the insured for the undamaged portion is subject to the stated amount of the building. If the limit is not at 100% of the replacement cost, there could be a coinsurance penalty or not enough dollars to rebuild. Many specialty carriers do not provide a blanket endorsement, thus each building is a stated amount.

Setting Limits

It is important to understand how to set limits for Coverage B: Demolition and Coverage C: Increased Cost of Construction.

This can be very difficult with many variables to consider, such as:

- Should this limit be stated as a sub-limit, thus reducing actual dollars to rebuild the structure?
- Or should these limits be separate from the actual replacement cost of the building?

Local Building Codes

Obtain as much information as possible as to local jurisdictional building codes. Even though local codes change frequently, it is logical that the older the building, the possibility of more changes in code have taken place.

Building Characteristics

Be sure to know any specific characteristics of the building. For instance, are there any special hazards, or circumstances, that exist that could increase the costs, such as the existence of asbestos or occupancy that is subject to public access?

Writing Separate Policies

Separate Property Policies should have the same coverage. If you are insuring a peril under a separate policy (earthquake and flood), the DIC carrier could require that the insured warrant the same coverage is in place for the All Risk policy. In the case of an earthquake loss, the DIC carrier would not be responding to the peril of fire following the earthquake, thus more than one carrier could be responding to one loss, as well as the loss to the undamaged portion of a building.

Questions?

If you have any questions, please feel free to contact your CID Insurance Underwriter. We appreciate your business and are confident that this information will help your client understand and select the proper coverage for this area of insurance protection.