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BY MARVIN MILTON, SWERLING, MILTON, WINNICK

Insurance coverage for code upgrades

mm Marvin Milton



Swerling,
Milton,
Winnick

Property insurance policies, even those with coverage for the broadest range of perils, invariably exclude damage due to the enforcement of building codes or ordinances. The language is usually quite explicit:

"We [the insurer] will not pay for loss or damage caused directly or indirectly by any of the following. Such loss of damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.

"The enforcement of any ordinance law 1) regulating the construction, use or repair of any property; or 2) requiring the tearing down of any property, including the cost of removing its debris." Form CP1010 (Ed. 10/91).

This exclusionary wording is incorporated even in re-

placement cost policies so that, although the measure of damages may be replacement cost, upgrades or changes mandated by building codes are still not covered. The exclusion became a festering problem in adjusting claims in the Oakland, Calif. firestorm of Oct. 1991 which destroyed approximately 2,000 upscale homes. Ultimately, the commissioner of insurance of the state prevailed upon insurers to include code upgrades in the adjustment of the losses.

The lack of insurance coverage for building code requirements is a very big void in property protection in urban areas. The buildings do not have to be of ancient vintage to be affected. Title III of the Americans with Disabilities Act can raise economic havoc upon relatively new properties.

Leaving aside questions of whether the order of a municipal building department to tear down a fire damaged building falls within the exception or is merely recognition and confirmation of conditions proximately caused by the fire itself, one can readily see

that the exclusionary language exposes the property owner to substantial hazards. It is not unusual for a building that has suffered a disastrous fire to come under the microscopic examination of an official from the local building department.

"Fortunately, the insurance industry has fashioned endorsements which the property owner can purchase for an additional premium that provide protection for this exposure. However, as is often the case with property insurance policies, collecting from insurers for the costs of complying with the enforcement of building codes is not without difficulties.

For example, Form CP 0405 (ed. 10/90) delivers a tripartite coverage package.

1. Part A provides insurance protection for loss by the enforcement of any ordinance or law to the undamaged portion of the building that;

"a. Requires the demolition of parts of the same property not damaged by a Covered Cause of Loss;

b. Regulates the construc-

tion or repair of buildings, or establishes zoning or land use requirements at the described premises..."

So, if a building is 50% structurally destroyed by fire and the code requires it to be taken down, this provision covers the cost of reconstructing the undamaged 50%. The limit of insurance is included within the overall limit applicable to the entire building.

Without this extended coverage, the insured would have to assert that, since the building had been at least 50% structurally damaged, it is a constructive total loss and, as such, he is entitled to collect under the basic fire coverage for the costs to not only demolish the whole building but also the costs to reconstruct the whole building.

2. Part B of the endorsement insures against the costs of actually demolishing the undamaged part and clearing the site of debris. The property owner, however, must purchase a separate, discreet limit of insurance for this coverage component and it must appear on the form.

How one can accurately forecast the requisite amount of insurance to be purchased for this protection is anybody's guess. The only certainty is that one cannot predict the degree of damage that a fire or any other insured casualty will cause. This leaves the question of the extent of the undamaged sections of a building perpetually up in the air.

3. Part C of the protection blanket is the one most frequently called upon to respond. This section covers for the increased cost of construction caused by the operation of the building code, law or ordinance to damaged and undamaged portions of the building. Thus, if a sprinkler system has to be installed when none existed or the damaged electrical system has to be brought up to code, then these provisions kick in.

A separate limit has to be purchased and designated on the endorsement for this increased cost of construction coverage. Again, how to compute the appropriate coverage limit is anybody's guess since realistically one can't prefigure the extent of the fire damage and the impact of the building codes.

Collecting from insurers for all of these constituent policy coverages is fraught with problems. There are many reasons for the tough going. Perhaps the most prominent is that code coverage is not a commonly disseminated and purchased package of protection. Hence, claims are not that frequent and claims adjusters for insurers have not had much experience with them. Insurance companies and their adjusters don't do well with novel situations; they are geared to handle routine, repetitive types of damages. Thus, when a code enforce-

ment claim is asserted, they are tentative and suspicious.

Another explanation may be derived from the very nature of the coverage provided and how it clashes with traditional property insurance basis. The overarching philosophical theme of property insurance is driven by the principle of indemnity. That is, the guiding measure of reimbursement under property insurance is to put the insured — the property owner — in the same position he was in before the loss — no better, no worse. Property adjusters are indoctrinated in the concept of indemnity almost from day one and it is a large part of their marching orders.

However, the contemporary policies marketed today by insurers depart in significant ways from the concept of indemnity. The property policy form that usually undergirds the code enforcement endorsement is characterized by the use of replacement cost as the measure of damages. Under replacement cost provisions, the insured ends up better than being indemnified — he receives new for old.

Then, layer Part A, of the code enforcement endorsement and its coverage for undamaged sections of the building on top of a replacement cost measure of damages and you have a compensation package that is almost too much for any seasoned property adjuster to endure. Insurance company adjusters have a natural aversion to paying for anything undamaged but there is a policy that mandates it! No wonder that there is hesitation delay.

But then, to add insult to injury, pile on the provisions of Part C with its commitment to pay for the increased costs of construction due to code upgrades

and you have an insurer paying replacement cost — new for old — to undamaged parts of the building and also including in the compensable claim costs of components that were never in the building in the first place! To insurance company claim adjusters, this is a revolution. Let it be said, though, that the language of the code enforcement endorsement is relatively clear and explicit. Despite the uneasy sense that property adjusters harbor that the insured is being unjustly enriched, the insurance companies developed and marketed these forms and the property owner paid an extra premium for them.

Perhaps the most annoying and grating part of the whole exercise to claims adjusters in the way that code upgrades are put in place. The guidelines that govern the reconstruction of buildings in Massachusetts are contained in 780 CMR, the Massachusetts State Building Code, 527 CMR, the Massachusetts State Electrical Code, 248 CMR, the Massachusetts State Plumbing and Gas Fitting Code, and various statutes like M.G.L. c. 148:261 with regard to fire protection systems, and Title III of the Americans with Disabilities Act. Now, these code and statutory requirements are not automatically and uniformly enforced. After a fire or other substantial casualty, building officials may or may not appear on the site to survey the scene. Generally, they do not go through the building checking off code violations that have to be addressed upon repair.

In effect, the codes and statutes are to a great degree self-enforcing in that the property owner, his architect or engineer, or his contractor incorporates all of the per-

ceived requirements of the code and statutes into the plans and specifications presented to the local building department in order to receive a permit to commence the repairs or reconstruction. The owner and his representatives are, in a sense, writing their own ticket. You can rest assured that if there is code enforcement coverage, the property owner will take advantage of it to modernize those aspects of the building that are most important to him. He'll push the envelope as far as he can and hopefully, avoid those danger zones that could cost him a lot of unreimbursed dollars.

In this process, the owner or his representative is selectively dictating to the insurer for what and how much he is to be paid for code upgrades. Insurance company claims personnel are intuitively suspicious of this scenario. Since most insureds do not want to risk embarking on a full menu of code upgrades without prior approval from the insurer, the list of requirements is submitted to the adjuster first. Then begins a high wire balancing act between acceptance of this controlled list and projected costs by the insurance company adjuster, the potential demands that may be imposed by the building and mechanical inspections and the limits of policy coverage.

While insurance protection for code enforcement is in many instances absolutely essential, the devil is still in the details.

Marvin Milton is a principal of Swerling, Milton & Winnick, Boston, insurance adjusters
