



## *Ordinance or Law Insurance Understanding the Gaps Getting them Covered*

Presented to  
*The Florida Bar's  
Insurance & Surety Committee*

August 21, 2017

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### *Thanks for inviting me.*

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- No insurance sales
- Fee based risk management consulting for clients paying \$500,000+ PC premiums
- Expert witness - insurance agent E&O claims – both sides



## Backdrop

- Insureds think they already have it
- Many insurance agents don't understand it
- No easy way to determine what is needed
- Codes vary by state, city, and lily pad
- It's expensive and hard to get



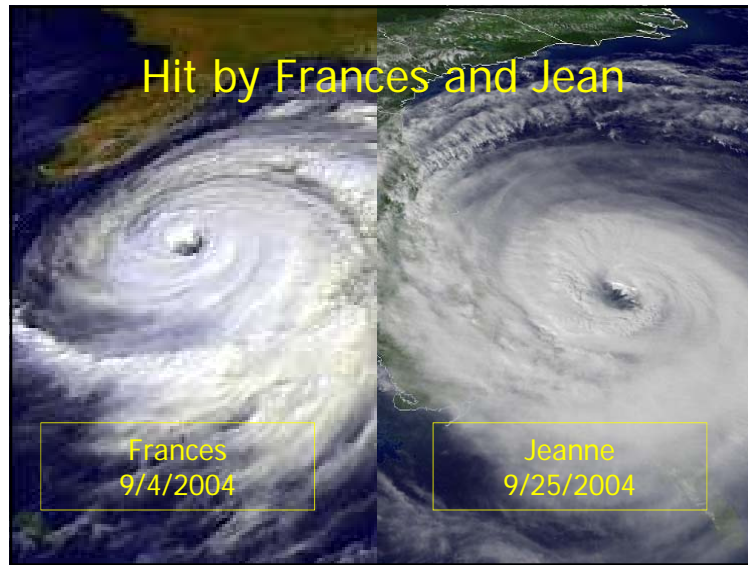
Older Garden Style Condo  
Central Florida -  
40 Buildings



Property Policy Included  
\$250,000 O/L



Hit by Frances and Jean



Frances  
9/4/2004

Jeanne  
9/25/2004

Uncovered O/L Damage –  
\$7,000,000+





## What We Will Cover

- Why is O/L coverage needed?
- For what limits?
- What about other O/L coverage gaps?
- Is it available? Affordable?
- What should be required in contracts?



## Why Is O/L Coverage Needed?



Agent said "Replacement Cost means new for old." (But it doesn't really.)



## It won't pay for...



The undamaged part of the building when the code requires it to be demolished



## or...



The cost to DEMOLISH the undamaged part of the building



So will this new building need O/L coverage when it opens?



We don't need that insurance. Our building is brand new!



YES, if the code requires the undamaged portion to be demolished, O/L coverage pays for the undamaged portion of the building and its demolition



Cost to bring damaged portion up to code





Cost to bring undamaged portion up to code



Cost to replace foundation mandated by code



After the Claim –

Who Decides What Has to Be Done, and When?



Ordinance or Law Coverages

Coverage A:

❑ Covers:

The value of the undamaged portion of the building which must be demolished

❑ Limit: Usually equal to the building limit



## Ordinance or Law Coverages

### Coverage B:

#### □ Covers:

The cost to demolish and clear the undamaged portion of the building

#### □ Limit: Must be selected by policyholder



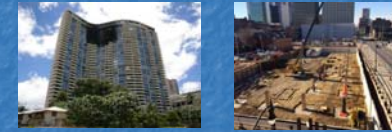
## Ordinance or Law Coverages

### Coverage C:

#### □ Covers:

- Bringing the damaged portion up to code
- Bringing the undamaged portion up to code
- Replacing the foundation if due to code

#### □ Limit: Must be selected by the insured



POLICY NUMBER:

COMMERCIAL PROPERTY  
CP 04 05 10 12

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

### ORDINANCE OR LAW COVERAGE

This endorsement modifies insurance provided under the following:

BUILDING AND PERSONAL PROPERTY COVERAGE FORM  
CONDOMINIUM ASSOCIATION COVERAGE FORM  
STANDARD PROPERTY POLICY

#### SCHEDULE

Building Number/ Premises Number	Coverage A	Coverage B Limit Of Insurance	Coverage C Limit Of Insurance	Coverage B And C Combined Limit Of Insurance
/	<input type="checkbox"/>	\$	\$	\$ *
/	<input type="checkbox"/>	\$	\$	\$ *
/	<input type="checkbox"/>	\$	\$	\$ *



## The BIG Question

How much coverage for demolition (B), and code compliance costs (C) do we need?





## Insurance Agents Have No Clue



## Most Replacement Cost Building Appraisers Have No Clue



Their software does not ask the right questions



## Hire a qualified engineer to do a detailed inspection and estimate



## Rules of Thumb

- Demolition costs of at least \$5.00 per square foot for bricks and mortar construction



## Rules of Thumb

- Costs to bring building up to code – .5% to 1% for every year



## Example

- Masonry commercial building
- 100,000 square feet
- Replacement Cost \$10,000,000
- 30 years old

How much O/L coverage to carry?



## Coverage A

Value of the Undamaged Portion of the Building

- Coverage is usually written for 100% of the building limit – so **\$10,000,000**



## Coverage B

Cost to Demolish the Undamaged Portion

If the local code requires that a building that is 50% damaged must be demolished, then:

- 50,000 square feet x \$5.00 per s.f. = **\$250,000 of Coverage B.**





## Coverage C

Bring the Building Up to Code

- If using .5% a year: 30 yrs. x .5% = 15%.  
15% x \$10,000,000 = \$1,500,000
- If using 1% a year: 30 yrs. x 1% = 30%.  
30% x \$10,000,000 = \$3,000,000
- So \$1,500,000 - \$3,000,000



## How Much O/L to Carry?

- Coverage A: \$10,000,000
- Coverage B: \$250,000
- Coverage C: \$1,500,000 - \$3,000,000

**But rules of thumb can be way off!**



## Footnote on Valued Policy Laws

- Florida has a valued policy law (as many other states).
- If a property is destroyed by a covered loss, generally the insurer must pay out the full face value of the policy.



## Footnote on Valued Policy Laws

- Scenario: Building is 50% destroyed by a covered loss. Code says the undamaged 50% must be demolished.
- Some say that is a constructive total loss, and the insurer must pay the full policy limit.
- If the courts agree, it would generally eliminate the need for coverage A.



## Plugging More O/L Coverage Gaps

- Property policy - business interruption and extra expense
- Mechanical breakdown policy – direct loss and business interruption/extra expense
- Damage caused by flood
- Non-standard forms



## Gap – Business Interruption and Extra Expense



- Adding O/L coverage to the property policy does not automatically add it to the business interruption/extra expense coverage.
- Add Ordinance or Law – Increased Period of Restoration - CP 15 31



## Gap – Mechanical Breakdown

- Mechanical breakdown – like an electrical panel arcing – can also cause an O/L loss.



## Gap – Mechanical Breakdown

- Outdated panel must be upgraded
- Additional down time
- Add O/L coverage to mechanical breakdown policy – direct damage & BI/EE





## Gap – Federal Flood Insurance

- Very limited O/L coverage
- Large commercial property portfolios may be able to negotiate more on excess flood policies



## Gap – Non-Standard Policies

- Many policies are written on company or broker forms
- These may provide more restrictive (or broader) coverage



## Is It Available/Affordable?

Often not – Insurers don't have a handle on how to rate it. So they are afraid to offer it and may charge dearly for it.



## Is It Available/Affordable?

- Often raises premiums 30% - sometimes much more.
- But we are now in a *very soft* property insurance market.
- *Now is the time to push for increased O/L coverage.*



## What Should be Required in Contracts?



## Ordinance or Law Coverage Suggested Minimums

### Minimums!

- **Coverage A** – undamaged portion – **100% of building limit**
- **Coverage B** – demolition – **2.5% of building limit**
- **Coverage C** – code upgrades – **10% of building limit**



## Ordinance or Law Coverage Suggested Minimums

- ❑ Obtain a real estimate from an architect or builder when possible.
- ❑ Be flexible due to insurance market realities.



## Additional Resources in Handouts

- ❑ My recent article is included in the handouts.
- ❑ The handouts also include a list of other articles on O/L with links to their website addresses.





## Questions and Comments

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