

# FEDERAL STANDARD ABSTRACT

## TITLE NEWS

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#### ACRIS Tax Lots

The Department of Finance will now require a deed, transfer tax forms, and a tax lot subdivision when conveying air space. This is a new rule expanding on the Department's well-known prohibition against recording deeds to partial tax lots. It remains to be seen whether this will affect: (a) the recording of negative easements for light and air; and (b) development rights transfers. The new rule appears to aim at attempts to improve another owner's air space and not at cases where the space would be left undeveloped. This would hint that negative easements and development rights transactions would be unaffected.

#### Peconic Bay Transfer Tax

The Peconic Bay transfer tax form was recently amended. The new form is available at <http://www.co.suffolk.ny.us/upload/countyclerk/pdfs/revisedcpf072908.pdf> and must be printed on legal-size paper. The Peconic Bay transfer tax is a regional tax, much like the City's Real Property Transfer Tax, and affects the five easternmost towns of Suffolk County, namely: Southampton, East Hampton, Southold, Riverhead, and Shelter Island. Monies collected go to the Peconic Bay Region Community Preservation Fund.

#### On Hazard Insurance Coverage

Purchasers of real estate are always faced with the question: How much hazard insurance coverage should I buy? A typical reasoning is: I want every dollar of the purchase to be insured against; e.g. If I buy for \$400,000, then I want to be insured for \$400,000. This is a conservative approach favored by insurance companies, but not as much by real estate investors.

Insurance payouts are measured by the loss suffered. In order to collect the maximum amount, the property would have to suffer a total loss; for example, a fire that consumes the entire building. Suppose after such an event the insured presents her claim to the insurance company. My property is completely lost, she claims, therefore I want full payment of the policy, the full \$400,000.

Not so, the insurer retorts. You may have lost the building, but you have not lost the land, which may be more valuable than the building. The amount of the payout will be calculated based only the loss of the building. If the land and the building were purchased at \$400,000 together, the payout on the insurance would be expected to be considerably below that amount. This is

the reason why real estate investors prefer to insure only up to the “replacement value” of the building. It is difficult to imagine scenarios where an owner would be able to collect more than the value of building itself. On the other hand, insurance over the replacement value would provide protection against rising building costs (consider the price of copper over the last few years).

Some purchasers take the opposite approach. To have a loss and collect on insurance is unlikely. To have a total loss and collect the maximum amount is even more unlikely. Therefore, how about buying insurance for less than the value? That way, I’d be covered against partial losses, which are far more likely than a total loss.

The problem with this approach is co-insurance. When an asset is underinsured, the owner and the insurer become co-insurers and suffer the losses jointly, pro rata. If the purchase price is \$400,000 and the replacement value \$300,000, but the owner only insures \$200,000, then the owner becomes a co-insurer as to one-third, and the insurer

only as two-thirds. In effect, this means that on every dollar of loss, the insurance company will only pay out \$0.67, even if the loss is well below the insurance coverage of \$200,000. For example, if fire destroys half the building and the loss is calculated at \$150,000, the insurance company will only pay two-thirds, or \$100,000. If the asset is insured for its replacement value or more, co-insurance does not come into effect. Practitioners would be wise to keep both issues in mind when advising purchasers on hazard insurance.

Another recurrent issue is that the bank often insists on hazard insurance coverage in the amount of the loan, even when the loan amount is more than the replacement coverage. The bank’s reasoning is perfectly sound: if the building burns down, why should I collect less than what I lend? Who will pay for the difference? Nevertheless, it falls upon the real estate practitioner to inform the bankers in this respect. Insurance law prohibits banks from requesting more insurance than the value of the insured assets. In other words, banks may not ask for more building coverage than the replacement value.

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