INVESTMENT RISK IN OLDER BUILDINGS WITH ZONING NONCONFORMITIES

Updated zoning ordinances place new demands on existing structures.

by Dudley S. Hinds

The presence of nonconforming provisions in a local zoning ordinance is a risk that often accompanies the investment in an older building. A "nonconformity" is a characteristic of a structure that was in accord with the zoning requirements when built but since has become contrary to the present regulations. Some nonconformities may have existed prior to the adoption of any zoning ordinance. Although a nonconforming use could not legally be recreated today in its present location (nor a nonconforming structure in its same form), the provisions of the ordinance permit a continuation subject to certain limitations. Such provisions comprise what is termed a "grandfather clause." However, the risk of investing in nonconforming properties arises from the limitations that are placed on continuation.

Limitations On Continuation Of Nonconformities

Limitations on continuation are designed to prevent any increase in the degree of nonconformity and eventually to bring about conformity. The limitations on continuation are usually applied separately to two major categories of nonconformities—uses and development standards. Provisions may vary from locality to locality, but some typical limitations are as follows.

1. A nonconforming use may be increased in extent or converted to another nonconforming use.
2. A nonconforming use which has been discontinued for a specified period of time (e.g. six months, one year) may not be re-established.
3. A nonconforming use may not be re-established after its structure has been destroyed in excess of a specified percentage of replacement cost.

4. A nonconforming use must be terminated after time has been allowed for the owner to amortize whatever investment there was in the structure when it became nonconforming. No attempt is made to ascertain the actual amount invested; instead, an arbitrary period of time is selected. Periods can vary from 40 years for uses in substantial buildings, to as little as two years for signs and for used-car lots where small structures are incidental to the use of the site.

Development standards include height of structure, floor area, lot coverage, setbacks, off-street parking and loading, buffers adjacent to residential districts, etc. Typical limitations on the continuance of structures that do not conform to development standards are similar to those pertaining to use. A nonconforming structure may not be

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enlarged or substantially altered to prolong its economic life unless it is being made to conform.

Like the IRS Code, there often is a distinction between a repair made to keep a structure usable and an improvement or substantial alteration made to increase its value or its economic life. The exact distinction can vary from place to place and is a potential source of disagreement. Many cities rely on the definition of the word "repair" as contained in their building codes. The definition of the International Conference of Building Officials, as used in various model codes, simply states that, "Repair is the reconstruction or renewal of any part of an existing building, structure or building service equipment for the purpose of its maintenance."[1] Stewart Stein defines the word alteration as "any change or modification in construction or building service equipment."[2] Stein, who has examined approximately 500 sets of construction regulations (including both zoning and building codes), offers eight representative definitions of the word repair.[3] While they vary in specificity, all are open to considerable interpretation when used to designate the differences between repair and alteration or improvement.

Another common provision relating to nonconforming structures provides that, following destruction in excess of a prescribed percentage of replacement cost, a nonconforming structure may not be rebuilt except in accord with the regulations. Destruction normally means damage by wind, fire or other so-called acts of God. In at least one case, however, a builder who was rehabilitating a complex of low-rise apartment buildings was challenged by neighbors who claimed that the very act of rehabilitation resulted in a temporary destruction and thus, the remodeled units needed to comply with all new development standards. The neighbors appealed to the zoning board of adjustment and the ruling of the building inspector was reversed.[4]

Risks For Investors

As indicated by the example just cited, nonconforming provisions can pose serious risks. An investor could possibly lose cash flow from operations and even a portion of the capital invested as a result of various combinations of events. But, some investments in nonconforming property may involve little risk. For example, a nonconforming single family residence in a commercial zoning district may be considered an underimprovement of the site and, parcel size permitting, might be replaced by a use and structure that would generate a higher new present value.[5] Where, however, a building represents an overimprovement of the site (nonconforming ground coverage, setbacks, offstreet parking, height or floor area), or where a nonconforming use, even in a conforming structure, permits higher rental income than could be obtained with a conforming use, an investor can face significant risks. Operation of the zoning provisions described previously could result in one or more of the following situations.

1. Inability to continue or restore a use could greatly reduce periodic cash flows. Vacancy could be prolonged while an attempt is made to adapt to a new set of conditions.
2. A damaged structure that is not permitted to be replaced must be written-off in its entirety by the investor even though the property insurance may treat it only as a partial loss. Generally, property insurance is designed to cover damages. Where an economic loss exceeds damages, the excess is not likely to be covered.
3. Where a structure has not been damaged but its use has been terminated, the structure may not be adaptable to a permitted use and must be written-off in its entirety.
4. Inability to expand a nonconforming use may result in refusal of a tenant to renew a lease and difficulty in obtaining a new tenant.

Existing Literature

Existing literature is sparse on investment risk posed by nonconforming provisions. A computerized search found few articles that even touched upon the risk involved: one dealt briefly with risks for lenders;[6] two dealt with the challenge to appraisers;[7] one discussed legal issues.[8]

Since nothing was found to indicate the scope of the problem nationwide, a survey was conducted of local governments. A questionnaire was designed and mailed to 46 cities as a pilot survey. The 36 responses were analyzed and resulted in modifications being made. An additional 1,555 questionnaires then were mailed out, making a total, including the pilot, of 1,601. The sample market was selected from an alphabetical listing of 2,558 cities grouped within an alphabetical roster of states. The list for the selection came from the *1982 Municipal Year Book*, Table 1/4.[9] The cities chosen were classified by size of population as follows:

Category	Population	Cities in Sample
Large	100,000+	158
Medium	25,000-99,999	902
Small	less than 25,000	1,498

TABLE 1A

Summary Of Mailouts And Returns
By City Size

City Size	Number of Cities	Sample Size		Usable Returns	% Of Sample
		Number	%		
Large	158	158	100	130	82.3
Medium	902	549	60.9	332	60.5
Small	1,498	894	59.7	446	49.9
Total	2,558	1,601	62.6	908	56.7

TABLE 1B

Summary Of Mailouts And Returns By Region

Region	Number of Cities	Sample Size Number	Sample Size %	Usable Number	Returns % Of Sample
Northeast	742	454	61.2	201	44.3
North Central	737	462	62.7	293	63.4
South	646	409	63.3	236	57.7
West	433	276	63.7	178	64.5
Total	2,558	1,601	62.6	908	57.7

TABLE 2

Switching Occupancy From A Noncomforming Use To Another Use

City Size	Permit Switching To: Any Use	Permit Switching To: Use In Same Or More Restricted Class	Prohibit Switching	No Response
Small	6.5%	51.6%	41.0%	0.9%
Medium	6.3%	62.7%	30.7%	0.3%
Large	6.9%	71.5%	20.8%	0.3%
Total	6.5%	58.5%	34.4%	0.7%

TABLE 3

Restoration Of Nonconforming Uses After Destruction Of Building

City Size	Not Permitted	Permitted If Destruction Not In Excess Of: 50%	60%	2/3%	75%	Other	No Response
Small	5.8%	55.2%	4.9%	9.9%	3.4%	19.5%	1.3%
Medium	4.5%	51.2%	5.1%	7.5%	2.7%	26.5%	2.4%
Large	4.6%	36.9%	8.5%	7.7%	5.4%	34.6%	2.3%
Total	5.2%	51.1%	5.5%	8.7%	3.4%	24.2%	1.9%

Because large cities are important to investors in older structures, it was decided to have a 100% sample in this category. However, budget constraints limited the medium and small categories to a 60% sampling, so the first three of every five cities were selected from the master list. Mailouts, returns and usable returns are summarized by the size of the city in Table 1A. Replies also were coded according to major census regions (Northeast, North Central, South and West [See Figure 1]) and these results are summarized in Table 1B.

Findings As To Nonconforming Uses Of Buildings

Re-establishment After Discontinuance

Most cities permit nonconforming uses to be re-established after they have been discontinued for less than some prescribed period of time. The most common limit is one year (44.3%) and the next is six months (28.7%). Other periods cited were one month, 18 months and two years. Only 8.4% prohibit re-establishment. The size of the city makes little difference in the responses. The six month limit is more common in the South (36.9%), while the one year limit is favored in the Northeast and North Central states (50.2% and 50.9%, respectively).

Changing One Nonconforming Use To Another

Approximately 34% of the cities in the sample prohibit a switching from one nonconforming use to another. Another 58% allow a switch, but only to a use in the same or a more restrictive category. Only 6.5% of the cities permit switching occupancy from a nonconforming use to any other use (see Table 2). The prohibition category includes 41.0% of the small cities, 30.7% of the medium cities and 20.8% of the large cities. Switching to another nonconforming use in the same or a more restrictive category is allowed by 51.5% of small cities, 62.7% of medium cities and 71.5% of large cities. The refusal to permit switching is most prevalent in the Northeast (43.3%) and least common in the North Central region (27.6%).

TABLE 4

Cities Permitting Additions Or Alterations To Structures Containing Nonconforming Uses

Category of Response	% Responding	
Yes, Permitted		45.4%
Without Significant Qualification	12.9%	
Alterations Only	7.9%	
Only with Variance or Special Permit	12.7%	
With Limitations on Size	10.2%	
Miscellaneous Qualifications	1.7%	
No, Not Permitted		53.3%
Without Exceptions	50.0%	
Except Alterations Required by Law	0.8%	
Except by Variance or Special Permit	2.1%	
With Miscellaneous Exceptions	0.4%	
No Response		1.4%
Total		100.1%*

*Error in total is a result of rounding.

Mandatory Termination After Prescribed Period Of Time

Only 13.8% of the cities have a mandatory amortization period for termination. The percentage ranges from 12.8% for small cities to 15.4% for large cities, and from 6.0% in the Northeast to 21.3% in the West. Answers on the length of the amortization period are open-ended and require further processing before they will be suitable for tabulation.

Restoration Of Use After Destruction Of Building

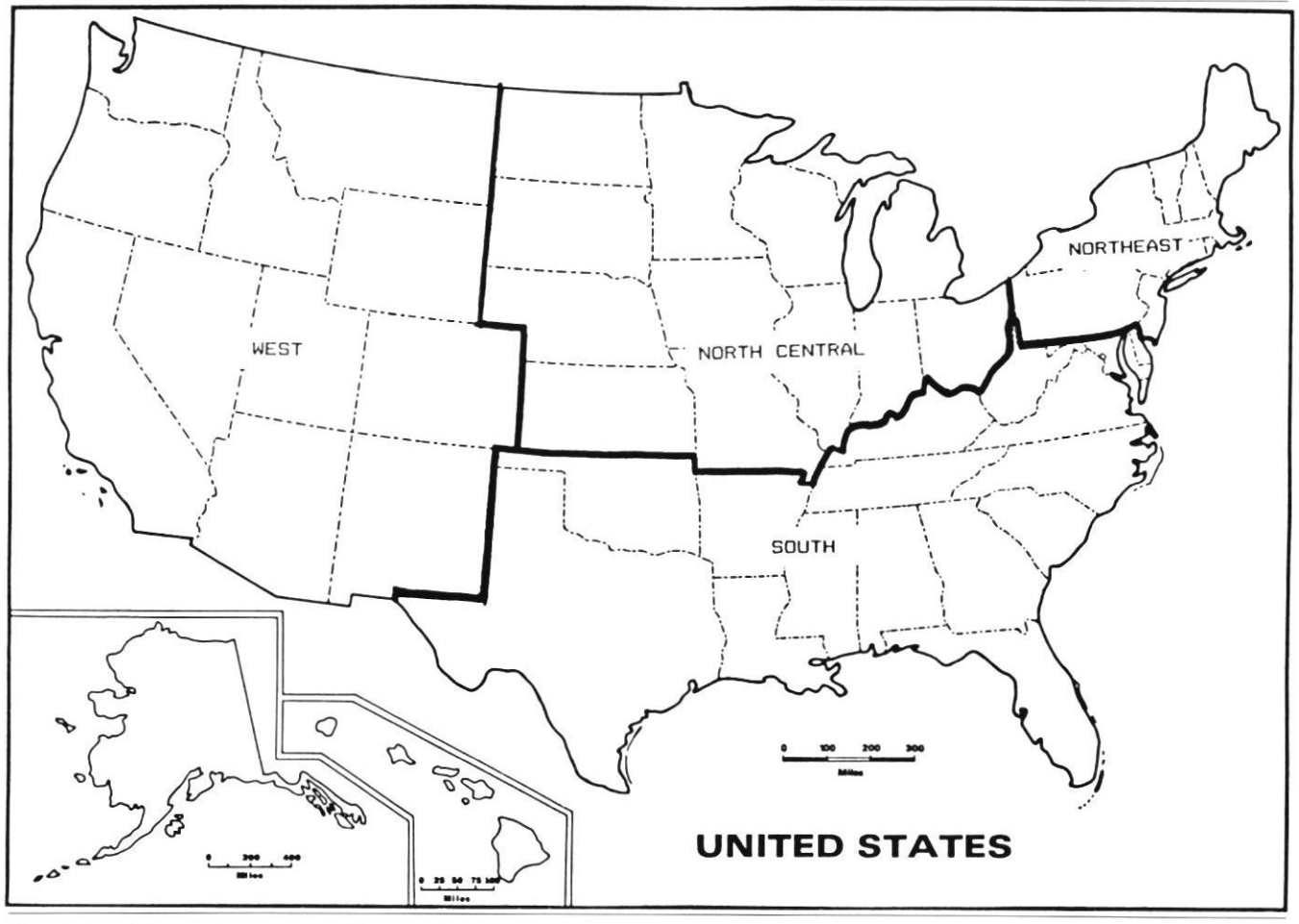
A majority of the cities permit restoration of a use after partial destruction of a building but not after full destruction. Those allowing the restoration differ, however, as to the degree of partial destruction tolerated and on the conditions to be met. Table 3 summarizes the responses as a percentage of the cities in each size group. Responses in distribution from the Northeast are similar to those from the large cities. Responses from other regions are much closer to the distribution for small and medium cities. The "Other" category includes a variety of answers not yet analyzed. Some do not limit restoration; others permit the restoration only within a prescribed time period; some require approval by a board. The destruction percentages, used as limits, generally apply to replacement cost, but some cities use market value or assessed value. Some exempt the building foundations from the calculated replacement cost.

Additions, Alterations And Extension Of Nonconformity

More than 53% of the cities prohibit additions and alterations that would extend a nonconforming use or prolong the useful life of the structure. The figure is 54.9% for small cities, 54.2% for medium cities and 44.6% for those in the large category. The South and North Central regions have the highest rates (58.1% and 58.0%, respectively), and the Northeast has the lowest (44.8%). Because of the many qualifications made to the responses, a simple tabulation of yes or no answers is misleading. For example, of the 412 "yes" responses (45.3% of the total), only 12.9% are without significant qualifications. Table 4 summarizes the major categories and subcategories of responses. Note that the "yes" response (but only with variance or special permit) is

FIGURE 1

Major Census Regions



Georgia State University, Department of Geography, Cartography Laboratory, 1974
Source: U.S. Department of Commerce Bureau of the Census

almost the same as the "no" response, except by variance or special permit. Together they comprise 14.8% of the total. Special permits require approval by a planning commission or by the local governing body; variances require approval by a board of adjustment.

Repairs Considered To Be Alterations

As mentioned earlier, the definitions of repair in general use do not appear to make a clear distinction between repair and alteration. A question was asked to ascertain if any cities had clarified the distinction by placing a limit on the value of repairs that was permitted. Approximately 28% of the cities responded that repairs in excess of a specified amount or percentage were considered to be alterations. There was a small range in this answer among cities of different sizes (from 26% in large cities to 30% in medium cities). But among regions, the answer ranged from 34% in the West to 30% each in the North Central and South, down to 17% in the Northeast. When the response stated that such a limit existed, an additional question was asked about the size of the limit. These answers were difficult to interpret. Of the 254 cities with a limit, only 186 provided clear responses on size, and some of the 186 confused this question with one earlier that dealt with restoration. The responses for the percentage of value above which a repair would be considered an alteration were as follows:

50%	93 cities
25%	27 cities
10%	25 cities
15%	7 cities
other %	23 cities
dollar limits	12 cities

One city (counted twice) has a 10% limit for nonresidential repairs and a 15% limit for residential repairs. Two cities reported that all repairs were considered alterations. Among the cities reporting dollar limits, amounts ranged from $100 (five cities) to $12,500.

Findings For Buildings Nonconforming As To Development Standards

Restoration Of Building After Full Or Partial Destruction

Most cities permit nonconforming buildings to be restored following partial destruction. Only 11.5% do not permit such restoration (14.0% in the South, down to 5.0% in the Northeast), but of those who do allow restoration, there is a difference in opinion on how much damage had to occur before the building is made to conform when refurbished. The variances in answers, arranged by city size, are displayed in Table 5. Except for the higher percentage in the "Not Permitted" column, the distribution is much the same as it was for the restoration of nonconforming uses. As before, the responses for the Northeast resemble those for the large cities.

Additions Or Alterations Without Making Entire Building Conform

Most cities (65%) permit an addition or alteration to a nonconforming building without requiring that the entire building be brought into conformity. A significant number, however, do not. Where applicable, this ranges from 32.3% for small cities, down to 25.4% for large cities, and from 38.9% in the North Central region, down to 16.9% in the Northeast.

Findings On Administrative Relief From Nonconforming Provisions

An overwhelming majority of the cities have a variance procedure for obtaining relief from the nonconforming provisions. This includes 86.3% of small cities, 81.0% of medium cities, 83.1% of large cities and 83.9% of all cities. The proportion is highest in the Northeast (92.0%) and lowest in the West (72.5%). Responses to a question about the success of requests for administrative relief are displayed in Table 6. Regionally, the "Usually Successful" figure was highest in the East (57.7%) and lowest in the West (39.9%). Table 6 offers some hope that the risk

TABLE 5

Restoration Of Nonconforming Buildings
As They Were

City Size	Not Permitted	Permitted If Destruction Not In Excess Of					No Response
		50%	60%	2/3%	75%	Other	
Small	11.2%	46.9%	4.0%	11.0%	3.1%	22.0%	1.8%
Medium	11.4%	45.5%	4.2%	7.8%	2.1%	26.8%	2.1%
Large	12.3%	30.0%	6.9%	9.2%	5.4%	36.2%	0%
Total	11.5%	43.9%	4.5%	9.6%	3.1%	25.8%	1.7%

TABLE 6

Success In Obtaining Variances
From Nonconforming Provisions

City Size	Usually Successful	Usually Unsuccessful	No Opinion	Not Applicable
Small	50.9%	9.4%	26.0%	13.7%
Medium	47.3%	6.3%	28.9%	17.5%
Large	56.2%	5.4%	21.5%	16.9%
Total	50.3%	7.7%	26.4%	15.5%

might be manageable in part by appeal in many localities. As the destruction (and therefore the need for an appeal) might not occur for several years, there remains the risk that the political environment could change in the interim. A possible solution is to request a waiver in advance, although this may present legal problems in some jurisdictions. In the survey, a question dealt with the number of requests received by municipalities in the past five years for advance waivers from the destruction/restoration provision for nonconforming buildings to meet lenders' conditions for obtaining mortgage loans. Only 4.8% replied "yes." For large cities, the figure was 9.2% and for small cities 3.6%. In the West, the figure was 10.1%; in other regions between 3.4-3.8%.

In Summary

To invest in buildings with zoning nonconformities involves the risks described earlier. Such risks will vary according to the size of the city and the region of the country. There also are individual differences between cities of the same size and in the same region. Property insurance will not protect against many of the risks. Effective risk management will require an analysis of the applicable regulations and political environment of the city where the investment is to be made to assess the magnitude of the risks; and, where possible, to obtain waivers in advance from any regulations that might prevent restoration after full or partial destruction.

NOTES

1. International Conference of Building Officials, *Uniform Administrative Code* (Whittier, California: 1985): 11.
2. Ibid, 10.
3. Stein, J. Stewart. *Construction Regulations Glossary*. New York: John Wiley & Sons, 1983: 564.
4. Sandler Associates et al v. Thomas B. Branch III et al, U.S. District Court, Northern District of Georgia, C 74-1838-A, 1975.
5. Quinlivan, J. Mark and Johnson, Vance R. "The Concept of Positive Economic Obsolescence," *The Appraisal Journal*, 49 (January, 1981): 46.
6. "Don't Get Trapped by Code Violations, Nonconforming Uses," *Savings & Loan News*, 97 n. 2 (February, 1976): 90-91.
7. Quinlivan and Johnson, op. cit., 45-51. See also Mourray, James W. "Legal, Nonconforming-Use Appeal," *The Appraisal Journal*, 34 (October, 1966): 592-595.
8. Aron, Jerry E. "Eliminating Nonconforming Uses by Amortization," *Florida Bar Journal*, 55 (April, 1981): 339-342.
9. International City Management, *Municipal Year Book* (Washington: 1982).

The author wishes to acknowledge the research efforts of Bryan J. Cohen and Benny Paktong Lui, graduate students at Georgia State University, whose assistance led to the development of this article.