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Managing Risk to Influence Successful Outcomes

Builder's Risk

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Builder's Risk Insurance An Often Misunderstood Coverage

When a company starts a construction or renovation project the subject of Builders' Risk inevitably comes up. It could be when the Construction Management Agreement (CMA) is being drafted or when reviewing lender insurance requirements, but it is bound to happen.

Builders' Risk is a "quirky" coverage in that it is written on non-standard form, covers a variety of exposures, and the terms of coverage generally not well understood by insurance professionals that do not specialize in construction insurance. So, as an Owner, what to do?

Well, first thing is to understand what you want to cover. Builders' Risk has three major coverage areas that can be included:

1. Hard Costs
2. Soft Costs
3. Delay in Start-Up (DSU).

Each area has nuances, but essentially, those are the three "buckets" you should consider.

Hard Costs (HC) encompass tangible construction values or trade costs for materials and equipment "that becomes a permanent part of the building or structure" (more on that later), including General Conditions/General Requirements. Considering the value of any existing structure needs to be considered–how will that be insured during the construction? I refer to these exposures as "values in place" (VIP), and approaching the HC, VIP-less demolished values will get you close to a pretty good Hard Cost schedule. Often, significant parts of the existing structure will be demolished and rebuilt. You need to be cautious that the values being declared do not "double count" the total of the two. In general, Hard Costs are easier to forecast, as the cost of materials is readily identifiable but is subject to inflation, tariffs, etc., so be sure to consider the forward cost of these materials, not just the "current" costs. For a new build, Hard Costs generally account for 70% or more of the total construction budget.

Soft Costs (SC), involve non-tangible expenses necessary for project progression and are essential in policy structuring. Examples of Soft Costs are inspection fees, project management costs, insurance payments, architectural, engineering legal, and financing fees, to name a few. The project owner must understand the difference in structuring the policy to respond to all costs in a loss scenario.

Builders' Risk policies do not automatically include coverage for a loss of rental/business income or costs incurred from a delay in project completion. This will include extended general conditions incurred from a delay, as this is a more specialized coverage that can be arranged, but it is NOT automatic.

There is a key difference of delay due to the loss, and delay in the performance of the schedule, which is often a hotly debated claim area. Calculating the coverage and formulating the business income amount from substantial completion requires careful calculation and consideration of insurable delay events. DSU is calculated when you miss the target date, which is when the Project will not realize the anticipated revenue. Any “delay” must be triggered by a covered cause of loss that usually involves direct physical loss or damage to the project.

Clear policy coverage, aligned with project specifics, ensures consistent and seamless cost capture in the event of a loss.

When this coverage is selected, coverage is, typically, the period between the expected completion date and the actual date use or occupancy begins after a loss. While many situations may result in a delay in completion, such as labor or material shortages and design changes, it is essential to differentiate and track delay events that are insurable versus not insurable. When the project owners’ revenue relies on the project being completed on time, a delay in completion most often results in a loss of income. Here are a few important definitions to know when dealing with a delay due to a loss:

- Period of Restoration – this is the time needed to perform the repairs.
- Period of Indemnity – this is the time required for the insured to recover financially to where they would have been had no loss occurred.
- Loss of Income – replaces lost revenue or profits that would have been earned by the insured had the project been completed on time absent a loss.
- Additional Construction Expenses are incurred in a lump sum and are not directly related to the length of the project delay. Examples include extra advertising and promotional expenses, inspection fees, and costs involved in rent concessions or lease renegotiation. A “per occurrence” limit is subject to the policies’ dollar amount deductible.
- Additional Soft Costs – are not incurred in a lump sum and increase with the delay in completion. Depending on the project size, there is often a time limit deductible of 14-90 days.

A delay poses complex issues involving many construction and financial questions. Clearly defining expenses, tailoring policy coverage, and aligning the agreement with the insurer prevents a claims adjuster from interpreting the agreement at the time of loss.

Extensions of Coverage to consider:

There are several extensions of cover in the Builders’ Risk policy that are useful to consider, and I have included a simplistic list below but, as we all know, the “devil is in the detail” and understanding coverage limitations in these areas are where the real analysis comes in.

·Goods in Transit Coverage ·Claims preparation costs

·Property Temporary off Site or in Transit ·Ordinance or law coverage

·Debris Removal with sufficient limits ·Pollution Clean-up

An essential distinction in 99% of the Builders' risk policies is the limitation to cover materials that "*that becomes a permanent part of the building or structure,*" so contractor's equipment, tools, machinery or other (rented) equipment that is used on the job site is generally not covered. This can (and likely does) include Cranes, Hoists (vertical transportation), etc. The coverage, direct and indirect (DSU), for these items needs to be considered. It is not unusual for a carrier to avoid DSU coverage for damage to such equipment. This is an exposure that is often not contemplated by the project team. A project delay due to a crane collapse, for instance, could be a costly and uninsured risk that needs to be considered.

Another overlooked area is loss or damage to Existing Real Property; when you are doing significant renovations to an existing building, damage to that (Existing Building), both the direct damage and the business income, need to be carefully considered. Trying to adjust a loss with two different (minimum) insurers is not ideal.

Given the non-standard nature of Builders' Risk policy forms, meticulous review and collaboration with experienced advisors become paramount. Working with qualified advisors to qualify and quantify the values exposed, negotiate the coverage needed, and ensure that everything is done with the Insured's interest first takes on a special emphasis when dealing with complicated exposures, many coverage variables, and non-standard coverage forms.

If you have any questions relating to these risks or need help with any risk or insurance related issues please contact Albert Sica, Managing Principal, at 732-395-4251 or asica@thealsgroup.com.