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Consider This: Insuring New Construction & Renovation Projects

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While most property owners are familiar with coverage for their portfolio of properties, there are some unique provisions and exposures inherent in property under construction, whether new or renovation of existing buildings. A properly structured Builder's Risk policy will ensure against the risk of loss or damage to these properties. However, it is not solely about the Builder's Risk policy; the construction documents should clearly outline the requirements and responsibilities for Property as well as Liability insurance coverage. It is important to engage in conversations with your insurance broker and insurance companies regarding a specific project prior to the construction documents being signed to avoid any issues that may arise with obtaining adequate coverage for the project.

PROPERTY COVERAGE

There are several considerations that are important when structuring a Builder's Risk policy for a project, such as:

- Specifying the property covered
- The parties insured
- The coverage to be included

A Builder's Risk policy is designed to cover the materials that are to be part of the permanent site once constructed; however, confusion may arise in a renovation project when there is an existing structure that needs to be insured as well. Other consideration needs to be given to covering materials off-site that are to become part of the finished project (even while in transit), as well as other tools, equipment and temporary structures erected during construction.

For residential conversion projects where the existing building is gutted and the building is fitted out for its new use, the coverage and valuation of the existing shell of the building is important. A typical Builder's Risk policy would cover the improvement to the existing structure, however the existing structure itself may need coverage as well.

Valuation of the existing structure is always a question, and insurance companies are likely to require appraisals to determine its value. This can be particularly difficult in renovations of certified historic projects to determine the appropriate limits of insurance for the existing structure. In addition, the determination would need to be made on whether or not to insure the existing structure on a replacement cost basis without any deduction for depreciation or an actual cash value basis, depending upon the owner's expectation for recovery following a loss.

THE PURCHASER

There is not one right answer as to whether or not the owner of the project or the contractor should be required to provide Builder's Risk coverage, however maximum control over the details can be attained by owners when they purchase the policy themselves. Regardless of who purchases the policy, the contract documents would typically require all parties (the owner and the contractor, including subcontractor) be covered under the policy. This will allow for the insurance company to cover the project and eliminate the need to seek additional recoveries from negligent parties, since they will all be insured under the same policy. Waivers of subrogation are common in construction documents, which prohibit the insurance company from subrogating against the contractor or owner for property damage to other people's work, but it needs to be worded properly depending upon who purchased the policy.

SOFT COST ENDORSEMENT

Another important consideration on the Builder's Risk policy involves soft costs that would be incurred as a result of a delay caused by damage covered by the policy. Damaged property and the cost of restoring the damaged property back to the condition prior to loss are generally covered under the Builder's Risk policy; however, soft costs need to be carefully determined and included to cover any other financial loss that would occur as a result of the delay in the project. Key items such as additional financing

costs, taxes, marketing and promotional expenses, lease commissions and fees, as well as costs incurred by contractors such as material storage and additional rental of construction equipment may be required. A properly structured soft cost endorsement on a Builder's Risk policy can cover these expenses to ensure the project can continue on budget despite the loss.

DELAYED COMPLETION COVERAGES

Another key component of coverage that would apply in the case of a delay in the project being completed on time would be the lost income as a result of the delay. Leases that have been negotiated and set to begin on a certain date that do not, as a result of the loss, will result in a business income loss of rents for the owner. Depending on the amount of time of the delay, these costs can be significant, and coverage can be included within the soft costs. For example, consider a situation where a residential conversion of former warehouse space into retail or residential leaseable space that is set to open where many of the leases have already been negotiated. In the event of a fire at the location close to the end of the project's completion that causes a six-month delay in the opening, the rents lost for that six-month period could be substantial and would need to be considered in obtaining coverage under the policy. In the event that leases are lost as a result, additional costs will be incurred in renegotiating leases and paying additional fees and commissions to obtain new tenants, and these coverages can also be included under the soft cost and delayed opening coverages.

LIABILITY COVERAGE

The contract documents should also clearly outline who is responsible for damage or injury to third parties or contractors' employees as a result of the construction. Workers Compensation and Liability insurance requirements should be included, with provisions adding the owner of the project as an additional insured. The limits required should be reflective of the size of the project and be required of all contractors and subcontractors working on the site. Indemnification provisions, which transfer liability to the contractor arising from the construction activities, should be required as well.

A note of caution is that not all coverage is created equal, and the additional insured provisions as well as contractual liability that will be included within the contractor and subcontractor insurance policies will vary greatly. The more specific the owner can be in the construction documents, the more likely the insurance requirements will be met. It is important to work with your insurance professionals

to determine the appropriate limits and other insurance requirements so that the appropriate parties' insurance companies will respond in the event of a claim. Oftentimes owners seek to have the insurance requirements in the construction documents give them ultimate protection from any liability, but that may not always be feasible or attainable by the contractors available or desired to perform the work, so a clear understanding of the intent of all the parties should be worked out upfront and reflected in the construction documents.

OCIPs & WRAP-UPS

For larger construction or renovation projects, often over \$100 million in total cost, an Owner Controlled Insurance Program (OCIP) or Contractor Controlled Insurance Program (CCIP), also known as a Wrap-up, can be considered to cover Workers Compensation for the contractors working on the site as well as for the Liability for damage to third parties. The advantage with a Wrap-up would be gaining control over the cost for insurance and ensuring a consistent level of coverage for the entire project. Since most Wrap-up insurance programs are loss sensitive in that the loss outcome on the job will ultimately determine the final insurance cost for the project, savings can be achieved by driving a safety culture for the project with clear accountability, which ultimately reduces losses. Another benefit is not having to worry about the level of coverage and protection provided under each subcontractors' policies, which would avoid disputes over whose policy will cover the loss.

As indicated above, there are many factors that create complexity with regard to insuring a renovation or new construction project. Construction documents are critical in outlining the requirements for insurance coverage, as well as who is included on the insurance policies and who is responsible for purchasing said policies. Other important provisions of the construction documents include waivers of subrogation, indemnification provisions and the limits required. Therefore, it is important that the insurance for a project is structured with the construction documents in mind, and the two are coordinated so that coverage is provided and the requirements are made clear. ■

Kevin joined The Graham Company in 1999 and is responsible for new business development and as a technical resource for the development and training of new producers. He is involved in the management of The Graham Company's Group Captive, is active in the Risk Assessment Practice Group and is the leader for both the Real Estate Practice Group and the International Practice Group. He can be reached at 215-701-5323 or ksmith@grahamco.com.