

Builder's Risk Policy: Insurance Owners Shouldn't Do Without

Typically, the owner of a large existing institution has a property insurance policy that includes coverage for incidental construction, which may lead owners to believe necessary coverage exists for all types of construction activities at their facilities. In reality, the scope of coverage may be limited. For example, the property insurance policy may contain a sizeable deductible whereby the contractor is responsible for an amount that is not in line with the project size or its financial wherewithal.

In addition, because most property insurance policies are renewed annually, they are not structured to provide consistent or guaranteed coverage levels for multi-year construction projects.

A standalone builder's risk policy can provide contractors with important protections that are not typically contained in the property insurance policy, such as limiting exposure to construction liabilities from insurer subrogation.

A builder's risk policy also provides insurance coverage for the entire duration of a project—a critical requirement when construction is expected to run longer than a year.

Contractors and owners need to consider whether it is prudent to rely on a property insurance policy for several reasons:

- Property insurers typically do not offer multi-year policies and will not guarantee project coverage beyond the annual expiration date.



- While a construction project is under way, a property owner's ability to secure favorable terms at renewal could affect the scope of coverage available for the remainder of the project. The revised renewal terms and conditions may not be influenced by the project exposures, but they can have a dramatic financial impact on the level of coverage afforded in the end.
- A property owner could have difficulty finding a property or construction carrier willing to accept construction risk in the middle of the project if the coverage is no

longer afforded under the property insurance program following renewal negotiations.

POLICY PITFALLS

Loss of coverage for project cost escalations is a major pitfall for projects insured through the incidental coverage of a property insurance policy. For example, a project that was initially valued at \$24 million could be covered under the property policy's \$25 million incidental construction sub-limit. But, if project costs escalate above \$1 million—or only 4 percent—the property insurance policy may no longer respond to any project-related loss. Therefore, when relying on property policy construction extensions, it is critical to verify the policy conditions upfront, carefully monitor project values and inform the property insurer prior to exceeding any contract value

thresholds.

In addition, relying on a policy extension may not be an option based on the scope of work being performed. For example, when substantially renovating a property, relocating or removing load-bearing walls, removing a sprinkler system or modifying a foundation, a building's structural integrity may be temporarily compromised and its protection features temporarily removed. The owner's property insurer could view this as a material change in risk and potentially deny coverage.

For complex renovations involving major structural modifications, a separate and specific builder's risk policy is warranted to provide the owner all-risk coverage for the duration of the renovation project.

However, in some situations, property and builder's risk policies can work together, such as when a project owner plans to partially occupy a new facility before construction is completed or will continue to occupy and operate the premises during ongoing renovations. In certain situations, the builder's risk policy provides property damage coverage for the partially occupied areas.

In the event of a loss, however, the builder's risk coverage for the property owner's business interruption exposure would not normally be triggered until the construction project's final anticipated completion date. The property insurance policy may fill business interruption coverage gaps for partially handed-over property exposures or for ongoing operations during renovations from the time of the loss, less applicable deductibles, until the facility is back in operation.

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In other situations, the builder's risk and property insurance policies could both respond to their respective business interruption exposures until the projects are completed, but that's where the similarities in coverage end.

While an owner seeks to insure its potential loss of future earnings following a construction loss, the contractor looks to protect against additional overhead expenses. A property insurance policy typically would not cover the contractor's extra expenses incurred after a project loss due to a delay, such as re-sequencing work crews and equipment or extending the construction schedule.

Because these expenses are associated

with the additional time required to complete the project, they typically are not covered by the property damage section of either type of policy, but are available through the purchase of a contractor's extra expense endorsement.

While some project owners look to minimize expenses by relying on their property insurance policy to cover a construction project, this cost/benefit analysis often overlooks the full array of project exposures.

A builder's risk policy can be tailored to provide soft costs, including additional advertising expenses, interim interest expenses on a construction loan, project refinancing costs and legal fees.

Through project-specific and appropriate coverage, standalone builder's risk policies can protect the financial interests of both the project owner and the contractor.

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