



# The Nitty Gritty

## An Explanation of Builders' Risk Coverage

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*The majority of Builders' Risk policies are written on nonstandard inland marine forms, and no two forms are the same; there is no such thing as a "standard builders' risk policy." The only way to know what a specific form does or does not cover is to read the form carefully.*

We're all aware that, from an insurance standpoint, construction projects involve risks unique to, and different from, existing, completed buildings, and that there are other unique characteristics to a project under construction:

- Covered property is likely owned by many different parties – the owner, general contractor and a myriad of subcontractors.
- The property may not be at the job site, but at an offsite storage location or in transit.
- Structures under construction are more susceptible to damage from the elements (wind, rain, hail, etc.) than completed structures.

Builders' Risk (BR) policies are designed for the specific purpose of covering property loss exposures associated with construction projects. Installation Floater (IF) policies are essentially a BR policy written to cover a specific type of property or work during its installation, for a single insured (e.g., installation of new plumbing in an existing building, for the plumber's interest only).

While it is possible to provide coverage for property under construction under the project owner's commercial property insurance program, this is usually not a desirable approach. The most obvious drawback is the inferior coverage it affords, especially for contractors and subcontractors, and there can be significant coverage deficiencies for property located off premises and while in transit.

### Who should buy the BR policy – owner or contractor?

Usually the construction contract between the owner and

general contractor (GC) addresses who is responsible for purchasing the BR coverage. The contract will most times include other important items concerning the BR policy, including specifics as to details of coverage, requirements for waivers of subrogation, deductibles, etc. Be sure you closely review the details surrounding the BR coverage, especially if you are required to provide it.

Many project owners prefer to purchase the BR policy because they believe doing so provides them greater security that the coverage is arranged properly and that their interests are better protected. On the other hand, most owners aren't buying BR coverage on a regular basis, so they are usually purchasing a "one off" policy for a project.

A GC's motivation for properly arranging and purchasing the BR policy is probably stronger than that of the project owner because the GC typically bears the risk of loss to the project. And the GC's regular involvement in the BR risk market usually provides them access to more favorable terms and rates than those obtainable by a project owner, who only occasionally enters this market.

### BR policy items of interest to all insured parties

**Insured parties** – The project owner, the GC and all subcontractors should all be insureds. There may also be a construction manager who has an insurable interest in the project.

**Waiver of subrogation (WOS)** – These same parties should have the benefit of a WOS. The WOS should also extend to the architect/engineer (A/E), even if they are not an insured. If not and a loss results from a design error, the BR insurer will likely attempt to subrogate against the A/E. Since most A/E's do not carry significant E&O limits, this action by the BR insurer can reduce those limits when they may need to be preserved for claims by other parties related to the same event ( i.e., third party liability claims).

**Property in transit or in offsite storage** – The form should include adequate limits and coverage for property that is in transit to the job site or in temporary storage at an offsite location. These coverages are very important in a BR risk policy because contractors and project owners often are responsible for loss to construction materials prior to their delivery to the job site.

**Excluded types of property** – Watch the list of types of property not covered. Typically these include:

- Existing property (see additional comments below)
- Contractors' tools, equipment and machinery not destined to become part of the structure
- Land, including the value of cut, fill and backfill materials that existed at the project site prior to commencement of the project
- Landscaping materials, including trees, grass, shrubbery, plants, etc.
- Waterborne and/or airborne property
- Signs
- Transmission or distribution lines, poles, towers and attached equipment (in some cases, exclusion only applies once energized at the completion of testing)
- Radio or television antennas, including lead-in wiring, masts, and towers

**Existing property exposures** – All but a very few specialty BR forms exclude any existing property at the job site. A couple of specially written forms contain language that insures the existing building, in addition to the renovation, rehab or addition work being performed. If you are the owner or a contractor on a job with exposures to existing property, it is advisable to use one of these forms so that one insurer is covering both new and existing work. This ensures better protection for all parties, especially the contractor(s), where the potential of causing damage to the existing structure exists. It also means there will only be one deductible, instead of two; one under the owner's property policy and one under the BR policy. If this approach is not taken, GCs should require that the owner release them from liability for potential damages to the existing structure and waive rights of subrogation from the owner's property policy for potential loss to the existing building and/or loss of earnings/revenue claims from damage to such. (See the AIA A201 wording as an example of wording to do so.)

### **Additional coverages you need included**

Many BR forms include a number of "additional" or

"supplemental coverages." Some are more meaningful than others. The more important of these include:

**Debris removal coverage** – Coverage for the cost of removing debris of covered property damaged by a covered loss.

**Expediting expenses** – Coverage for costs incurred to speed up repair of damaged property, such as overtime wages and express transportation charges.

**Trees, shrubs and plants** – Coverage for loss of trees, shrubs, plants and other landscaping items. In some forms, this coverage may be limited to certain specified causes of loss.

**Site preparation costs** – Coverage for the costs of site preparations, such as excavation, grading and backfilling, which are incurred as a result of a covered loss.

**Testing coverage** – For loss resulting from start-up or performance testing, usually of machinery and equipment. Testing coverage may or may not extend to "hot testing," which generally refers to testing a newly constructed processing facility (such as an oil refinery or power plant) by running the substance that the facility was designed to process through the system to determine whether the facility meets specifications. See the separate discussion of testing coverage later.

**Excluded losses** – common types of losses not insured against to be mindful of:

- War, nuclear hazard and seizure or destruction of property by governmental order
- Dishonest acts of the insured and the insured's employees
- Mysterious disappearance or shortage found when taking inventory
- Wear and tear, gradual deterioration, corrosion, rust, rot, mold, inherent vice, latent defect, insects, rodents, birds and other animals, except resulting unexcluded loss
- Settling, cracking, shrinking or expansion of walls, ceilings, floors, roofs, foundations, etc. (except ensuing unexcluded loss)
- Changes or extremes of temperature and humidity
- Damage by rain, snow, sleet or ice to property in the open
- Asbestos removal or other loss arising out of the presence of asbestos
- Delay, loss of use, loss of market, fines, penalties and other consequential losses (see discussion on Soft Costs)



- Flood, mudslide, sewer backup and seepage of water (coverage can usually be bought back)
- Earthquake, volcanic activity and other earth movement (coverage can usually be bought back)
- Testing (see discussion below)
- Design error, except resulting damage (see below)
- Faulty workmanship or materials, except resulting damage (see discussion below)
- Collapse, except from specified causes

**Testing exclusions** – Some BR forms contain a testing exclusion. The scope of these exclusions vary significantly, but most intend to exclude only “hot testing,” which is directed at excluding coverage for startup, commissioning or other forms of testing on power and processing plants. If a project involves hot testing, be sure the BR form covers such and that resulting damage to property, other than the equipment being tested, is covered.

**Faulty Workmanship or Materials** – All BR policies contain some sort of exclusion applicable to losses due to faulty workmanship or materials. The purpose of this exclusion is to avoid providing coverage for a contractor’s failure to perform the work properly. There are different approaches, but most insurers give back coverage for damage resulting from the

faulty workmanship or materials. Be sure you understand this coverage and that the policy forms you use preserve coverage for resulting damage.

**Design Error** – Similar to faulty workmanship, most BR policies contain a design error exclusion, but again, most provide coverage for resulting damage from such an error for an otherwise covered cause of loss. This type of design error exclusion eliminates coverage only for the cost of correcting design errors, leaving intact coverage for physical damage which results from a design error. The preservation of coverage for resulting damage is a paramount coverage in all BR policies for the owner, GC and the architect/engineer.

Occasionally we see an exclusion for loss or damage arising out of the performance of professional services by an architect or engineer. This type of exclusion is different and more troubling than a design error exclusion. Unlike the exclusion just discussed, there is no exception for resulting damage. This wording should never be accepted.

**Occupancy Issues** – Some forms include an occupancy provision that says coverage ceases when the building is occupied or put to its intended use. In others, partial occupancy of a building is allowed. To avoid any potential issues, it is advisable to remove any such restrictions.

**Contractor's Overhead and Profit** – Be sure the BR form makes it clear that the value of damaged covered property includes the contractor's overhead and profit. Contractor overhead and profit is a component of the repair cost which is every bit as legitimate as the bricks-and-mortar component of the cost and should be covered by the policy.

**BR Limits** – BR policies typically have more than one limit of liability. Typically there is one limit applicable to property at the construction site, another limit for property in transit and yet another limit for property at offsite storage locations. If the policy includes soft cost coverage, there will be a separate limit applicable for it. There may also be sub-limits applicable to certain insured perils, such as earthquake, flood and testing. Understand each and how they apply.

**Deductibles** – BR risk coverage is always written subject to a per occurrence deductible. In some situations, there may be several deductibles; one that applies to all losses, except those subject to a specific deductible (usually for higher exposure perils such as flood, earthquake, and testing, for example). If the policy includes soft cost coverage, a separate time-based deductible will usually apply to this section.

**Soft Costs Coverage** – Damage to a project under construction often produces loss beyond the physical damage to the project itself – the “hard costs.” Perhaps the most significant of these type losses is that resulting from a delay in the completion of the project.

Owners typically have the biggest exposure to soft costs. As an example, when a project is delayed, owners likely suffer the loss of the anticipated revenue stream that could have been earned if the building were finished on time. In addition, a variety of other additional costs will likely be incurred as a result of the delay, such as additional financing costs (e.g., interest on construction loans and other lender fees), additional insurance costs, additional real estate taxes, etc.

In the case of the contractor, there are soft cost exposures, but typically these costs are reimbursable to the contractor under the terms of the construction contract, assuming the owner elects to rebuild the damaged project. Examples include costs for general overhead, equipment costs (owned and rented), etc. Again, most are reimbursable to the contractor from the owner as rebuilding of the project commences and are part of the BR hard cost claim. If, as a contractor, you believe you are exposed to soft costs, they can be included, but realize that you must substantiate any such costs at the time of loss to be able recover them.

Coverage for “soft costs” can usually be included in the BR policies, either within the basic form or by endorsement to the policy. Under either approach, the insured party with the exposure (usually the owner) must elect the coverage, determine their exposure to loss and select limits and pay an appropriate additional premium. Whether included within the basic form or added by endorsement, soft cost coverage follows the coverage of the basic BR form, including covered parties, covered causes of loss, coverage territory, etc., discussed earlier in this section.

**Soft cost coverage exclusions** – These exclusions are in addition to the exclusions that exist in the basic BR policy form. Some of the more common and major exclusions for soft cost coverage include loss from:

- Strikes
- Breach of contract, late or non-completion of orders
- Unavailability of subcontractors
- Unavailability of funds for repair or reconstruction
- Changes in the design, plans or specifications

### Conclusion

Be sure to read the contract, whether you are the owner or the contractor. If you are responsible for purchasing the BR coverage, know what that obligation is and do not over commit in the contract to the coverage you are required to provide. For example, the standard AIA A201 requires the owner (this is often changed to the contractor) to purchase BR coverage which includes full flood and earthquake limits. Is that what is intended? Are those limits and coverages available? Are they needed? Are they affordable?

No two BR forms are the same. Be sure you:

- Understand the coverages and exclusions in the form you buy
- Have coverage for “resultant damage” from faulty workmanship, materials and design
- Watch for testing exposures and exclusions
- Consider “soft cost” exposure

Good luck in your endeavors to purchase the perfect the BR policy and call us if we can help!