

8 KEY CONSIDERATIONS FOR A BUILDER'S RISK POLICY



As owner of the new manufacturing facility building project, Thyme Manufacturing Co, Inc. has recently hired the project's general contractor - Perkins Construction, Inc. In addition to developing the [minimum insurance requirements](#) to be used with Perkins Construction and its subcontractors, as Thyme's newly appointed director of risk management, Jennifer is also responsible for arranging the insurance for the building during the course of its construction. This "course of construction" insurance is commonly known as builder's risk insurance.

Thyme's legal counsel has used the American Institute of Architects (AIA) construction contract documents with Perkins Construction – including the 2007 A201™ General Conditions of Construction.¹ Of particular interest to Jennifer is Article 11.3 entitled "Property Insurance" – as this section will serve as Jennifer's *starting point* to determine Thyme's *minimum* builder's risk insurance requirements.

WHO PURCHASES BUILDER'S RISK?

Because of its market clout Perkins may be able to obtain the builder's risk insurance for the benefit of Thyme at either a lower cost or with better coverage terms – charging any premium for the insurance back to Thyme. While the option of having the general contractor purchase the builder's risk is permitted under the AIA A201™- 2007, Thyme opts to purchase the builder's risk coverage itself. Thyme's owner Justin concludes that Thyme should control the builder's risk insurance because the new facility represents such a large investment by Thyme – Justin directs Jennifer to purchase builder's risk insurance directly.

AMOUNT, TYPES OF PROPERTY AND SCOPE OF COVERAGE

Jennifer has been told to look for a "completed value" builder's risk insurance policy, meaning the building limit should at least be equal to the full contract value of the project when completed, including the value of any changes or modifications to building. Jennifer learns that certain types of property not normally covered in a typical property insurance policy may be critical for builder's risk insurance – such as coverage for temporary buildings & structures, temporary fencing, falsework², the cost of excavation, site preparation, foundations and underground pipes. Jennifer also discovers that it is important in placing builder's risk insurance to distinguish between *new construction* and the *renovation* of an existing building – builder's risk insurance policies usually *exclude* coverage for an existing building that is being renovated.³

As the Thyme manufacturing facility is new construction, Jennifer does not have to be concerned with coverage for the renovation of existing buildings.

The causes of loss that are required to be purchased are quite broad – "all risk" or an equivalent policy form, specifically listing causes of loss typically understood to be included in a "special" causes of loss property insurance policy – such as theft, vandalism, malicious mischief and wind – as well as listing several causes of loss that are *not included* in "special" causes of loss forms. Coverage for flood, earthquake and boiler and machinery (equipment breakdown) including testing and startup is usually needed in a builder's risk policy and is required of Thyme by the AIA A201™- 2007 contract with Perkins. As many builder's risk policies are written on inland marine forms, coverage for some or all of these causes of loss may be automatically included, but with aggregate sublimits.

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CONTACT

To learn more about how AmWINS can help you place coverage for your clients, reach out to your local AmWINS broker or marketing@amwins.com.

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OTHER COVERAGE EXTENSIONS

Coverages important to Thyme include the following. While not necessarily unique to a builder's risk policy, are typically offered by insurers also with sublimits:

- Expediting Expenses
- Debris Removal
- Ordinance or Law
- While At Temporary Storage Locations (materials and supplies that will become part of the building)
- While in Transit (materials and supplies that will become part of the building)

INTERESTS INSURED

In electing to purchase the builder's risk insurance in accord with the AIA A201TM-2007, Thyme has agreed to include coverage in the builder's risk policy for not only their interest, but also the interests in the project of Perkins and any other contractor, subcontractor or sub-subcontractor. Unless others object, Thyme is authorized to settle a claim with the builder's risk insurer, but holds the proceeds as a fiduciary for other insured interests. Further, Jennifer notices that Thyme is required to continue the builder's risk insurance in effect until final payments have been made or Thyme is the only person or organization with an interest in the project – whichever is later. The time period for which Thyme has agreed to maintain the builder's risk in force will influence the selected policy period – particularly if the project is expected to take over one year. Jennifer's research has revealed that obtaining a builder's risk policy from a new insurer on a building that is partially completed is very difficult – if available at all – and thus the strong preference to continue the same builder's risk policy until the project is finished.

DEDUCTIBLES AND SUBROGATION

Thyme is considering a larger deductible – \$25,000 – to keep premium costs down. This raises a question – if the loss is caused by the negligence of Perkins or a subcontractor, can Thyme charge the deductible to that responsible party? After a conference with Thyme's legal counsel, Jennifer learns that Thyme cannot recover such costs because Thyme has agreed to the AIA A201TM-2007 conditions – which clearly state Thyme is responsible for any loss within the builder's risk deductible. In fact, Thyme's legal counsel points out to Jennifer that Thyme has waived its rights against Perkins and any of their subcontractors or sub-subcontractors to the extent that the builder's risk policy (or other property insurance) provides coverage for the damage. Further, Perkins and its subcontractors and sub-subcontractors also waive any rights they may have to recover from Thyme – again, to the extent the damage caused is covered by insurance. The implications of the waiver clause are clear to Jennifer – the builder's risk policy she purchases must allow Thyme to waive its rights against all other interests covered by this policy – including damage to the project that is not the work of a subcontractor or sub-subcontractor.⁴

OCCUPANCY OR USE

As might be expected, Thyme's owner, Justin, is very eager to get the project finished and is already asking Perkins when he can move into the new facility and start manufacturing. Apparently this may be a problem – Jennifer learns that a builder's risk policy may cease providing coverage if Thyme begins to occupy the new facility. However, after some inquiry, she finds that insurers will generally grant permission to occupy. After a discussion between Jennifer and Justin about this matter, Justin agrees to give Jennifer as much notice as possible before he begins occupying the new facility – giving Jennifer time to seek permission from the insurer for occupancy and avoid losing coverage under the builder's risk policy.

LOSS OF USE

An area that is not at all clear to Jennifer is the section of the AIA A201TM-2007 contract that is entitled "Loss of Use Insurance." While Jennifer understands that Thyme has waived all of its rights of action against Perkins for loss of use of the facility due to "fire or other hazards, however caused" and also knows the purchase of this insurance is at the *option* of Thyme, she does not know what is meant by "loss of use insurance."

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DELAY IN COMPLETION/SOFT COSTS

If an insured cause of loss damages Thyme's facility and that damage results in a delay in the project completion, Thyme could suffer two types of consequential loss:

1. **Loss of Income.** Thyme is building the new facility as it anticipates expanding its manufacturing to develop increased revenues of 30% in the first year alone. If a fire were to delay the facility's opening by one year, then Thyme would suffer a net income loss resulting from its failure to realize the 30% revenue increase. Coverage may be arranged on the builder's risk policy for Business Income coverage that would respond to the loss of net income that would have been earned for the period of the delay.
2. **Soft Costs.** In addition to being exposed to the *loss of income* that may result from a delay in the completion of its new manufacturing facility, Thyme is also exposed to *additional* costs that are unique to a construction project. For example, the delay in completion may require Thyme to pay interest for a longer period on its construction loan – in lieu of its planned permanent financing with lower interest costs. In fact, the permanent financing may be lost entirely, requiring additional accounting and legal costs to renegotiate the permanent financing. Project administration costs, such as security, may continue beyond what was budgeted. Design fees may be greater because of the delay. The additional insurance costs incurred by Thyme during the period of construction (including the incremental additional costs of the builder's risk insurance) may continue longer than expected because of the delay. Depending on the type of project, other soft costs may be incurred, including advertising or marketing expenses that must again be incurred if the project was to be sold; similarly, additional legal or accounting costs may be incurred to renegotiate leases if the project was to be leased to others. Insurance for soft costs usually specifically lists and describes each additional expense covered as soft costs – it is important to closely examine the soft cost coverage and compare what is offered to what additional costs an organization similar such Thyme may incur if the project is delayed due to damage caused by an insured cause of loss.

CONCLUSION

Jennifer has a strong understanding of the general contours of Thyme's builder's risk insurance needs, including its obligations under its construction contract with Perkins. However, she has a great deal of work left to do – starting with choosing a building limit, including sublimits for certain coverages and coverage extensions, as well as whether and how much loss of income and soft cost coverage (including the categories of soft costs coverage) to purchase. In addition, upon review of builder's risk proposals, it is important for Jennifer to review the policy forms being offered to make sure she has the coverage she wants or needs, including but not limited to the causes of loss, whether all interests are insured and whether Thyme's waiver of it rights against the others is allowed in the policy. Finally, Jennifer needs to explore limitations in the builder's risk policy as respects occupancy by Thyme – will the insurer permit occupancy – if so, when and under what conditions.

About the Author

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² Falsework is defined as the temporary structure erected to support work in the process of construction. Source: dictionaryofconstruction.com

³ Coverage for an existing building undergoing renovation can usually be arranged, often with a separate limit from the value of the renovations and often on an actual cash value basis.

⁴ "Thus, to determine which fire damages are covered by the subrogation waiver, we must look at everything that follows the phrase 'to the extent.' The positioning and plain meaning of the word "covered" restricts the scope of the subrogation waiver based on the source and extent of the property insurance coverage, not the nature of the damages or of the damaged property." Bd. Of Comm'rs of Cnty. of Jefferson v. Teton Corp., 30 N.E.3d 711 (Ind. 2015)