CLIENT ADVISORY

3 EXPOSURES TO CONSIDER ON A BUILDER'S RISK POLICY

HARD, SOFT AND BUSINESS INCOME EXPENSES

The resurging construction industry means that builder's risk submission activity is on the rise. As such, it's important to understand this line of business. Here's an overview of some things to consider on a builder's risk policy.

Construction contracts generally require the building owner or the contractor to purchase and maintain a builder's risk policy. The policy provides coverage for loss or damage to the unfinished building's construction materials on the work site during the course of construction, subject to certain restrictions and exclusions. The policy can also be extended to cover existing structures if the project is a renovation. Exposures are broken down into three general parts: hard costs, soft costs and business income or loss of rents.

Hard costs are the tangible assets that comprise the construction project; quite simply, the costs of material and labor associated with a project – also known as "sticks and bricks."

Soft costs, also known as Delay in Opening Expenses, are usually covered and limited by special endorsements to builder's risk property policy. Coverage is provided for additional construction loan interest, real estate taxes, marketing and re-leasing expenses, administrative expenses, and architectural/engineering fees which are incurred as a result of a covered loss – one that causes delay in completion of a project. These expenses can be further broken down into two sub-categories: construction expense and additional soft costs.

Construction expenses are fixed costs incurred during the delay in construction, and **additional soft costs** are costs that are more likely affected by the *length* of the delay. Construction expenses include but are not limited to: additional advertising, public relations, or promotional expense, architectural/engineering fees, inspection fees, loan fees and non-interest financing fees, and cost to extend permits and licenses. Additional soft costs include but are not limited to: additional loan interest, real estate taxes, expense to lease equipment and temporary office space, operational expenses (salaries, utilities, etc.), and insurance expense.

Builder's risk policies can also be extended to provide the owner coverage for **Business Interruption (BI)** or **Loss of Rent** due to a delay in start-up. Much like BI on a standard property policy, the extension typically covers operating profit, fixed costs, expenses that continue post-loss, and expenses incurred to reduce or avoid a delay in opening.

In the event of a covered loss, the typical soft cost provisions in a policy provide coverage for the costs incurred from the date the construction would have been completed (had no loss occurred) until construction is completed, and is subject to the insured exercising due diligence and dispatch.

Calculating the delay period is complex and requires the broker to be knowledgeable about the specific and unique attributes of a project, as well as a deep understanding the coverage form.

For example: what is the difference between the Period of Restoration and Period of Indemnity? The Period of Restoration refers to the time necessary to perform repairs, whereas the Period of Indemnity refers to the time required for the insured to financially recover had no loss occurred. This is just one example of how being knowledgeable about builder's risks policies can make you, the broker, a more informed resource for your insured client.

Whether an insured is able to obtain adequate recovery or not depends heavily on how these three coverage parts and extensions interact in the event of a claim. Choosing a wholesale broker in the construction field with this specialized expertise and experience is a critical part in the marketing and placing your client's builder's risk coverage.

This article was authored by Harry Tucker, Grant Chiles and Frank Catalano, members of AmWINS' national Property Practice.

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.