US Assure

Builders Risk Insurance

Reducing Risk:
5 Coverages Worth Considering

Introduction

To properly address a client's risk exposure, agents offering builders risk insurance need to have a solid understanding of specialty coverages and endorsements that offer added value, as well as the insight to explain various risks and benefits associated with each. This guide provides important considerations for agents around five specific builders risk coverages and endorsements:

1. Changes in project value
2. Soft costs
3. Water intrusion
4. Business income and extra expense
5. Flood and earthquake

These risks tend to be overlooked often because builders risk policies are requested at the last minute and require a quick turn-around. In addition to clients' costly losses, agents also run the risk of lawsuits and claims against their own errors and omissions insurance if they fail to offer all available options or to document clients' decisions to decline such coverages.

1. Changes in Project Value

Changes to materials and equipment or the scope of a construction project often occur after construction has begun, resulting in a higher cost to the property owner. In the context of builders risk insurance, these changes can result in a gap between the policy coverage limits and the actual value of the structure due to new or more costly materials or enhancements to the original design. These are commonly referred to as change orders.

Agents issuing builders risk insurance should **educate clients as to how change orders during construction impact the insurance coverage** when the project value is increased.

Agents issuing builders risk insurance should educate clients as to how change orders during construction impact the insurance coverage when the project value is increased. Change orders are commonplace in residential construction. However, often as a practical matter, homeowners and residential contractors do not always associate the change in construction plans as a need to alert their insurance agent.

Some insurers offer additional protection to cover such change orders, helping the client avoid possible coinsurance penalties if a claim should occur before the increase in completed value is properly reported to the provider. This is often done as an endorsement for additional coverage of up to 10, 20 or 30 percent should the total value increase during the policy term. This provides the insured with peace of mind knowing that coverage is in place if it is needed to protect them from additional loss. In a perfect world, homeowners or contractors would always advise their insurance agent of changes that increase construction value. Adding coverage to account for change orders means protection is in place even when notification does not occur in a timely manner.

Change orders occur most frequently with residential construction projects. Commercial projects certainly have the potential to add enhancements during the course of construction; although, this occurs less frequently because of pre-defined scope parameters and is generally not necessary. These projects have fewer changes in value during construction because of more detailed planning and budgeting, and greater involvement by architects, engineers, risk managers, and contractors. When changes do occur during commercial construction, it is more likely the contractor will need to obtain a revised certificate of insurance from their insurance agent, who then has the opportunity to adjust coverages as needed.

Regardless of the type or value of the construction project, insuring for the total completed value is always advisable because no one knows if or when a loss will occur. On some forms, carriers will apply a penalty, upon loss, if adequate limits are not requested. Carriers will not pay a greater share of any loss than the proportion that the limit of insurance listed on the declaration pages or the value reported bears to the value of the project on the date of completion.

If the policy contains a coinsurance clause, coinsurance acts as a penalty in which the insured pays a share of the loss for not insuring the project to full value. Coinsurance can be a source of frustration to agents and policyholders. Let's look at this from a basic commercial underwriting standpoint:

> *Divide* the amount you ***DID*** insure the project for by the amount you ***SHOULD*** have insured the project for then *multiply* that percent by the amount of the loss *minus* the deductible.

For example, a project with a policy limit of $500,000 sustained covered losses of $100,000 due to wind and hail damage.

It might appear that the provider would be responsible for the total amount of the loss. However, once the coinsurance is applied, the provider might not be responsible for the full amount. The final equation might look something like this:

> $500,000 (**insured value**) divided by $600,000 (**actual value**) = .833 x $100,000 (**LOSS**) = $83,330 paid loss minus any deductible that may apply.

In this example, the project is insured at a value of the $500,000, which is only 83.33 percent of the actual value, after the loss incurred. Therefore, the provider is only responsible for paying $83,333 or 83.33 percent of the $100,000 in actual damage sustained after the deductible is applied.

Even if the policy does not have a coinsurance penalty, the contractor or homeowner could still be penalized on a sizable loss if the value of the project exceeds the amount of insurance at the time of the loss and the limit is less than the loss amount.

2. Soft Costs

Soft costs refer to expenses incurred during construction that are not associated with labor or building materials but that can nevertheless be directly attributed to a covered loss. Examples of soft costs include expenses that need to be paid again or expenses that arise as a result of a covered loss. Following are a few examples of soft costs; however, these will vary as the term is not standardized among providers:

Agents must **help the client clearly identify and define** hard versus soft costs.

- Advertising and promotional expense
- Interest on construction loans
- Architects, engineers and consultants fees
- Real estate and property tax assessments
- Commissions or fees for renegotiations or leases
- Insurance premiums
- Legal and accounting fees
- Fees for licenses and permits

While soft costs exist in both residential and commercial construction projects, the need to add coverage for items not included in the carrier's standard coverage occurs more frequently with commercial construction. Agents need to exercise care in differentiating between soft costs and hard costs, which would include payroll, materials, costs associated with grading the land, etc.

Agents also need to understand how builders risk partners define soft costs and hard costs, and make sure additional soft cost coverage limits include only the items necessary for the client's specific construction project. For example, insurance companies often have a pre-defined list of standard items that are covered as soft costs for builders risk policies. If an agent does not fully understand what is included in that list and inadvertently adds coverage for something already included, the client could be overcharged.

It is also important to note that coverage is not automatic just because a soft cost is included in the policy; those expenses are only covered when another covered cause of loss is the reason the soft costs occurred or re-occurred. Often, the project must first meet a certain deductible calculated by the number of days of delay before soft coverage is applicable.

While the client is ultimately purchasing the policy, agents must help the client clearly identify and define hard versus soft costs. If a soft cost is not specified in the builders risk policy, it will be excluded should a loss occur.

US Assure

3. Water Intrusion

In builders risk insurance policies, water intrusion specifically refers to water intruding on a structure during construction that is not the result of physical damage to the property. Rather, the intrusion results from contractor oversight or negligence. For example, rain that enters a partially completed building through an open window or unfinished roof is considered intruding water.

Agents should review available policy endorsements to **determine whether coverage for water intrusion is available**, and not just for water damage resulting from another covered peril.

Damage caused by water intrusion is often specifically excluded from builders risk policies. In essence, such exclusions state that only water damage occurring as a direct result of another covered cause of loss, such as a pipe bursting, would be covered under the policy.

To address the potential risk of loss inherent in this type of policy exclusion, water intrusion coverage is available as an endorsement on some commercial builders risk policies. Whether water intrusion coverage is standard to the policy or purchased as an endorsement, if water penetrates a covered commercial structure during construction and causes damage, the loss would be covered under the terms of the insurance contract. Water intrusion coverage is typically not available for residential builders risk policies because of a greater perceived risk that damage will occur due to a contractor's negligence.

When searching markets for builders risk insurance, agents should review available policy endorsements to determine whether coverage for water intrusion is available, and not just for water damage resulting from another covered peril, such as a named storm or flood.

4. Business Income and Extra Expense

When a loss occurs during the course of construction for a commercial project, there are often additional losses that arise because one or more business entities cannot open or re-open on schedule. Business income and extra expense endorsements for builders risk policies are designed to address those losses. By its nature, this type of coverage is not available for residential construction projects.

It is a better practice to **attempt obtaining coverage than to presume coverage** cannot be added.

Generally available for any size commercial builders risk project, this endorsement is designed to cover lost income and additional expenses resulting from a covered cause of loss, including:

- **Loss of rents:** If delays in construction prevent the owner of a commercial building from leasing space to tenants, loss of rents would cover the loss of rental income due to tenants not being able to move into the space as originally planned.

- **Loss of business income:** When a building cannot open for business on time, the owner has an insurable interest in the loss of business income due to a delay in start-up operations.
- **Extra expense**: Covered loss incurred as extra expenses includes expediting, soft costs not covered within the policy, labor costs, and mitigating expenses. The business income and extra expense endorsement will help pay those costs to protect the structure from further damage.

Although contractors and others may sometimes be named insureds on builders risk policies, only the commercial building owner who has an insurable interest arising from loss of income or rents can obtain proceeds from business income and extra expense coverage, and then only if that building owner was a named insured. Banks or other lenders sometimes request this coverage for construction projects; however, agents should understand that lenders are generally not elegible.

With many builders risk insurance partners, business income and extra expense coverage may only be available for existing businesses that have been in the same type of business for a minimum of two years and for owners with tenants leasing space who already own buildings with the same level of occupancy. New or start-up businesses don't have a track record of income on which to base coverage, so many insurers will not extend this endorsement to newcomers' construction projects.

However, some builders risk partners are willing to offer coverage for new businesses under certain circumstances. For example, a new business owner who has a solid business plan, obtains bank financing to start his or her own business after working in the same industry for several years, demonstrates proficient knowledge and experience, and can project business income with a reasonable degree of certainty would be a suitable candidate. It is a better practice to attempt obtaining coverage than to presume coverage cannot be added.

Agents writing commercial builders risk insurance can add value by helping clients identify the additional coverage amounts needed for loss of income or extra expenses, and should make sure clients understand that the requested time limit for loss of income or extra expense endorsement coverage should never exceed the original policy term.

5. Flood and Earthquake

Earthquake coverage is not always offered in every geographic location. However, if a construction project is located in an area with an earthquake zone designation, then such insurance coverage can be critically important in helping clients mitigate loss during construction.

Mother Nature **does not limit floods** to designated zones.

Flood insurance is available separately in many geographic areas from the Federal Emergency Management Agency (FEMA) through the National Flood Insurance Program (NFIP). Whenever possible, the client securing builders risk insurance should be encouraged to include coverage for flood damage as part of their builders risk policy rather than purchasing a separate NFIP policy. Doing so can help avoid potential conflicts that can occur when there are multiple policies covering the same project. With more than one insurance company involved, determining which insurer is responsible for adjusting and paying claims can be a challenge and a potential area of dispute, especially when the loss could result from two types of covered causes of loss such as windstorm and flood.

Whether or not a client's construction project is considered to be in a flood zone, including coverage in the builders risk policy for damage caused by floods merits consideration. Ongoing changes in the environment have escalated the fact that Mother Nature does not limit floods to designated zones.

Flood and earthquake coverage is available for both residential and commercial construction projects. Agents can demonstrate increased value to clients by educating them on the limitations and potential issues inherent in purchasing separate flood or earthquake coverage outside of builders risk policies.

Mitigating an Agent's Risk

The coverages discussed in this guide are common in various builders risk insurance markets, and agents issuing builders risk insurance need to understand how its coverage may fit clients' needs.

If an agent offers these coverages to a client and the client declines to purchase the endorsements, the client has knowingly accepted additional risk. On the other hand, if coverage is available but the insurance agent fails to offer it to a client, the agent may be held liable. When an agent does not consider, explain or offer available endorsements, or increased coverage limits to address a risk for a client's construction project, the agent's exposure to potential lawsuits and claims against their errors and omissions policy increases.

If coverage is available but the insurance agent fails to offer it to a client, **the agent may be held liable**.

As a best practice, agents are encouraged to document these various coverages were offered, and whether the client accepted or declined. A best practice is always to use a standard template to clearly and concisely define what optional coverages are offered to a builders risk insurance client—requiring the client to initial the template documenting whether they accepted or denied the coverage.

Conclusion

It is the insurance agent's responsibility to help protect clients from costly losses and exposures. A large part of that responsibility is being able to adequately identify and explain potential risks and offer specialty coverages and endorsement options to clients.

The endorsements addressed here are not all-inclusive. Taking the time to learn about the risk outside of standard builders risk policy coverage means agents issuing builders risk policies are in a better position to offer clients coverage they didn't know they needed for their construction projects.

This not only protects the client against loss and the agent against errors and omissions claims, it also reinforces the agent's consultative role as a trusted insurance advisor. Establish a good relationship with a knowledgeable builders risk underwriter who can explain and help secure these additional coverages for your client.

For additional information, contact our dedicated team of more than 50 specialists at (800) 800 - 3907, or visit **usassure.com**.

Request a Consultation

About US Assure

US Assure is a premier program administrator and insurance services provider. With nearly 40 years of experience in the construction industry, US Assure exclusively manages, distributes and services the Builders Risk Plan insured by Zurich, and other property products, throughout the United States and Canada. Agents interested in partnering with US Assure to access the Builders Risk Plan insured by Zurich can register online in four easy steps for instant access with no minimum commitment. Registered US Assure agents are equipped to provide a comprehensive range of builders risk products for projects of any size and value. For more information, visit **usassure.com**.

Start doing business online today when you register in four easy steps at **usassure.com.**

Register Now

US Assure

usassure.com | (800) 800 - 3907
8230 Nations Way, Jacksonville, FL 32256

US Assure is an independent, third-party administrator managing policy processing for certain builders risk policies issued by Zurich and its affiliated companies. US Assure does business as US Assure, Inc. and US Assure Insurance Services of Florida, Inc. In California, US Assure operates as InLink Insurance Services (CA license # OD44490).

This is intended as a general description of certain types of insurance and services available to qualified customers. Your policy is the contract that specifically and fully describes your coverage. The description of the policy provisions gives a broad overview of coverages and does not revise or amend the policy.