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Builder's Risk Insurance: What costs are covered in the event of a loss?

Construction contracts typically require the building owner/investor or general contractor to purchase and maintain a builder's risk insurance policy that covers loss or damage to the unfinished building and/or construction materials on the work site during construction (subject to certain restrictions and exclusions).

Because no two construction projects are the same, builder's risk policies and coverages can vary widely depending on the insurer.

For retail agents and brokers to best serve their commercial construction clients' needs, it is vital they are familiar with potential risk exposures for the project and the optional coverages available to mitigate their clients' expenses in the event of a loss.

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To learn more about how Amwins can help you place coverage for your clients, reach out to your local Amwins broker.

LEGAL DISCLAIMER

Covered Losses Under Builder's Risk

Generally, builder's risk exposures are divided into three categories: hard costs, soft costs and business interruption (BI) or loss of rent.

Hard Costs

Hard costs are perhaps the easiest to define as they are the physical property and tangible assets (materials, labor, landscaping, etc.) associated with a construction project—also known as "sticks and bricks." Losses are typically covered in the event of severe weather, fire, vandalism, theft, etc. Builder's risk policies, in their most streamlined form, typically would only cover hard costs.

Soft Costs

When disaster strikes, however, physical damage losses aren't the only expenses incurred due to a covered event. Often, losses on a job site will result in project delays that impact other costs, such as additional construction loan interest, fees for re-inspecting the re-built building or extending permits and licenses.

These are considered soft costs, generally meaning any additional or continued expenses that would not have occurred if there wasn't a construction delay as a result of a covered loss.

If soft costs are not specified in the builder's risk policy these expenses will not be covered by despite only existing because of the damage caused by a covered event.

Soft costs are usually covered and limited by special endorsements to the builder's risk policy, and because individual policy terms ultimately define soft costs, it is important for agents and brokers to assist clients in considering all potential expenses that should be included based on the unique aspects of the project.

The following are some of the most common soft costs associated with construction delays:

- Advertising and promotional expenses to announce a new opening date
- Interest on construction loans
- Additional permit fees and re-inspection fees
- Architects, engineers and consultant fees for revised plans
- Insurance premiums
- Real estate and property taxes
- Extended General Conditions

It is important to remember that even itemized soft costs are only covered when they are the direct result of a covered loss (e.g., fire, vandalism, etc.) under the builder's risk policy. It also isn't uncommon for the insurer to require a certain minimum deductible (calculated by the length of the delay) first be met before the soft cost coverage is triggered.

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.

Business Interruption

When a loss occurs during construction of a commercial building, the building owner might miss out on loss of revenues if the construction delay interferes with business operations. Builder's risk policies can be extended to provide the building owner coverage for Business Interruption (BI) or Loss of Rent due to a construction delay.

For example, the construction delay associated with a retail center might prevent the building owner from leasing space to tenants who originally planned to move into the space. This loss of rental income would be covered by Loss of Rents, which is the lost revenue from rents and/or leases which would have been earned absent a delay, minus non-continuing expenses.

Likewise, BI coverage addresses loss of revenue/income which would have been earned absent a delay. It's comprised of the sum of net profit or loss and continuing normal expenses. 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.

Takeaway

Agents working with commercial construction clients need to understand the coverages and limitations of builder's risk policies so they can help their clients identify and obtain the additional coverages needed in the event of a loss. Choosing a wholesale broker with specialized expertise in the construction field is critical to ensuring your clients' needs are covered.

Amwins has a dedicated builder's risk construction specialty practice with experienced brokers worldwide, as well as exclusive Risk capacity available only through Amwins brokers. Contact your Amwins broker today.

About the Author

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