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Builders risk insurance: Projects require review by all concerned parties to avoid coverage disputes

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For new construction and renovation projects, a clear understanding of how to properly insure the project's property is most important.

For a new construction project from "the ground up," a completed value builders risk form is used. The policy must be written for 100% of the total value of the completed structure at the inception of policy. This allows for a lower rate since the values of the project increase from zero to completed values over the duration of the project. The insurer will rate the project on the average value of the project thereby reducing the rate.

For renovation projects, both the existing structure and the new construction need to be insured. Many insurers, however, will provide only actual cash value for the existing structure's shell but replacement cost on the new additions. Actual cash value is defined as replacement cost minus depreciation. Thus for older existing structures, the depreciation can be substantial. In the event of a disaster, this may create a valuation shortfall, creating possible financing hardships. It is important that the form provide the maximum value of the new construction added to that of the existing shell.

In most regular property forms, items such as underground piping, foundations, and other site structures are either not covered or limited in value. These are usually not damaged by the usual perils such as fire, etc. Since these items are exposed to weather, vandalism, collapse or other perils during construction, the values of these items need to be included in the builders risk policy's total value.

Other frequently overlooked items are building materials both on site and in transit from the supplier. On site building materials should be included in the builders risk coverage. Determination needs to be made on who will insure the property in transit from the supplier.

In regular insurance policies, time element or "business interruption" insurance will cover the loss of income during the period of restoration of the property. This traditional business interruption insurance does not provide for the unique economic losses inherent to a building project. The required coverage is known as "soft costs".

Soft cost coverage insures the economic risks caused by delays due to a covered peril. Examples include advertising, promotional expense, commissions, fees for renegotiation of leases, additional insurance premiums for the additional time to complete the project, revised architectural fees, taxes and rental of construction equipment. On large projects, soft costs can be up to 25% of the building costs. It is important that all parties involved, the owner, general contractor, and sub-contractors be adequately covered for soft costs.

Soft cost deductibles are usually expressed in time waiting periods as opposed to dollar amounts. Long waiting periods deductibles can significantly reduce the soft cost claims causing delays or financing issues.

All builders risk projects should require review before a project starts. While smaller projects such as new single-family homes may not require the extensive coverage noted above, large commercial projects require up front review by all concerned parties to avoid coverage disputes.

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