

# **AMERICAN ASSOCIATION OF INSURANCE SERVICES INLAND MARINE GUIDE BUILDERS' RISK - UNDERWRITING**

## **COVERED PROPERTY**

Builders' risk insurance is intended to cover buildings or structures while they are being constructed. This coverage is sometimes referred to as course of construction (COC) insurance. Builders' risk coverage can be written on a completed value (scheduled location) or reporting form basis. Risks with numerous on-going projects are often written on a reporting form basis. Also, a builders' risk policy can be written for the contractor that is constructing the building or for the eventual owner of the building.

## **RISK SELECTION**

The ability and willingness of an insured to control key hazards is an important factor in selecting a builder's risk. The information that can be obtained on the control of key hazards prior to offering a quote will depend on the coverage that is written.

### **Scheduled Location Coverage**

Evaluation of accessibility, water supply, and required security is relevant to a scheduled location risk and is possible because a scheduled location risk covers a fixed location. Factors related to the actual process of erecting a building (construction practices, private protection, and bracing) cannot be properly evaluated. A scheduled location risk does not have a physical process (work in progress) to evaluate until construction has begun and coverage has already been bound.

When writing a scheduled location risk, it is sometimes possible to make an indirect assessment of the process of erecting a building prior to binding coverage. This indirect evaluation is possible if other lines are written for the contractor or if other builders' risk projects have been written for the contractor. Reviewing the construction practices, private protection, and bracing of previous projects will provide information on the quality of hazard controls for new projects. Contractors who are in the habit of using good hazard controls, tend to continue doing so from jobsite to jobsite.

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To underwrite builders' risk at a scheduled location, obtain the following information:

1. limits, perils insured, deductible amounts
2. policy term
3. jobsite security
4. description of site
5. public protection class at each scheduled location
6. the number of buildings or structures at each location
7. construction classification of each building
8. number of floors for each building
9. the value of each building
10. intended occupancy for each building
11. distance of each building to a working (tested) hydrant
12. accessibility to the location over paved roads
13. exposure to sinkholes
14. estimated completion date

## **Reporting Form Coverage**

Evaluation of construction practices, private protection, and bracing is possible when selecting a builders' risk reporting form. These factors can be evaluated because there is on-going construction (the process of erection) at various jobsites. However, the factors related to a fixed location (accessibility, water supply, and adequacy of security) cannot be determined prior to the effective date of coverage because coverage for different locations is continually added and deleted during the term of a policy. These locations are reported only after construction has begun.

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To underwrite builders' risk written on a reporting (open) form basis, obtain the following information:

1. limits, perils insured, deductible amounts
2. operating territory
3. receipts
4. jobs and values:
  - a. type (residential or commercial)
  - b. annual number of jobs
  - c. duration of jobs
  - d. maximum and average number of jobs in progress
  - e. maximum, minimum, and average value of each job
  - f. job site security

## **Monthly Reports**

Monthly builders' risk reports can be obtained in lieu of the information listed under jobs and values.

Monthly reports of values for 12 months can be requested and should list each builders' risk project under construction during the month covered by the report including the:

1. location of the project
2. construction classification
3. completed value
4. intended occupancy

The monthly reports can be used to analyze:

1. the types of locations the projects are constructed in (e.g., low or high crime areas, low or high public protection classification).
2. average and maximum values.
3. the types of projects being constructed (e.g., frame dwellings, noncombustible office buildings).

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**High Hazard Builders' Risk**

The following types of builders' risk are considered high hazard classes because of the catastrophic exposures inherent in the risks:

1. bridges, tunnels, piers and dams
2. rehabilitation projects or renovation projects or any existing structure
3. buildings already in the course of construction (i.e., midterm builders' risk coverage)
4. paper mills and chemical plants
5. any risk that uses an experimental building or construction technique
6. any building or structure that incorporates any unusual or experimental design
7. utilities with testing coverage

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## KEY HAZARDS

Fire, theft and vandalism, and collapse are the key hazards to consider when underwriting builders' risk coverage.

IT IS IMPORTANT to know that all of the required information on the control of key hazards may not be obtainable prior to writing a builders' risk policy. To understand how the evaluation of key hazards relates to risk selection, refer to Risk Selection.

### Fire

The potential for catastrophic fire damage is often greater during the course of construction than after a building is completed. The reason for the increased potential is that a building in the course of construction lacks the protection and construction features that are designed to contain the spread of fire or limit the extent of damage. Fire proofing may be incomplete, fire doors will not be installed, and standpipes and sprinklers will not be operating. Therefore, it is important to understand the hazard of fire as it relates to a builders' risk.

The following characteristics are inherent in a builders' risk project and affect the hazard and control of fire.

#### Housekeeping

Scaffolding, wooden concrete forms, insulation materials, straw for curing, and packing material can create a large accumulation of combustibles. A jobsite should be organized so that construction materials are safely stored. Trash should not be allowed to accumulate.

#### Hotwork

Welding and cutting operations should be conducted away from combustible materials. A fire watch should be posted in the area during welding and cutting operations and for 30 minutes after hotwork is completed.

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## **Flammable Liquids and Gases**

Spare gas cylinders should be stored upright with valve cover in place and secured to prevent tipping. Fuel gases should be stored apart from oxidizing gases. Flammable liquids should be stored and dispensed from U.L. approved tanks, cans, and containers.

Flammable liquids should be stored where they cannot be damaged and away from sources of ignition.

## **Heating**

Temporary heat should be provided by U.L. listed and properly installed gas, oil or electrical heaters. Bonfires and drum fires should not be used for heating at a jobsite.

## **Accessibility**

Access roads to the jobsite should be completed prior to any construction above ground level. The jobsite should be accessible to the fire department.

## **Water Supply**

A fully operable fire hydrant should be located within 500 feet of the building prior to any construction above ground level.

## **Fire Extinguisher**

One 2A fire extinguisher should be located every 5000 square feet with a maximum of 75 feet travel distance from any point in the building. Fire extinguishers should be located on each floor of a building under construction.

## **Telephone**

Someone at the jobsite should have a cellular telephone so the police and fire departments can be called during an emergency.

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## **Sprinklers and Standpipes**

Sprinklers and standpipes should not be operational until the building can be heated. Frozen pipes can burst, causing water damage.

## **Theft and Vandalism**

An unoccupied structure under construction can be an attractive target for theft and vandalism. When a jobsite is also isolated, it becomes an even more attractive target. Plumbing supplies, electrical wiring, and bricks are often stolen from commercial structures. Appliances and heating and air conditioning units can be stolen from dwelling structures.

JOBSITES SHOULD BE FENCED or protected by a watchman in areas where theft and vandalism are a concern.

## **Collapse**

Collapse may be caused by wind, faulty workmanship, or design error.

### **Wind**

Long masonry walls are subject to collapse from strong winds before the roof or a floor is in place to tie down the walls. All masonry walls should be properly braced until they are tied down by the roof or a floor. Examples of structures that have long masonry walls include shopping centers or malls, warehouses, exposition halls or arenas, and supermarkets.

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## **Faulty Workmanship**

Partial or total collapse of a structure can result from faulty workmanship during the erection of the structure. Types of faulty workmanship that can result in a collapse are:

1. abnormal settling of the foundation because of unanticipated soft soil conditions and inadequate number or placement of piles or caissons;
2. improperly erected structural supports including expansion joints, incorrect erection sequence, and inadequate temporary supports;
3. loads being applied to floors before concrete is properly cured.

General contractors and all subcontractors should have experience in erecting buildings that are similar to the builders' risk project being covered.

## **Error in Design**

An unusual building design may require using a new construction technique, novel building materials, or untested engineering calculations.

REVIEWING THE ARCHITECT'S CONCEPT DRAWING of the proposed building will usually reveal any design features that may raise questions about the risk. A loss control review should be conducted if a design feature raises a concern.

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**ENDORSEMENTS AND OPTIONAL COVERAGES**

The following is a list of endorsements that modify the builders' risk coverage form.

**Delay In Completion, Rental Income, and Income Coverage**

Delay in completion (formally known as soft costs), rental income, and income coverage are types of time element coverages that are designed for builders' risk exposures.

**Delay In Completion** - Delay in completion coverage consists of coverage for additional construction expenses and additional soft costs. These are additional expenses and costs that the insured incurs during the delay period. The delay period is the amount of time completion of the project is delayed, and the delay must be caused by a covered cause of loss to a covered building.

Additional construction expenses tend to be incurred without regard to the length of the delay period. This is the reason the builders' risk deductible instead of the waiting period applies to additional construction expenses. Additional construction expenses consist of:

Advertising -- Additional advertising and promotional expenses.

Design Fees -- Additional fees for architects, designers, consultants, engineers.

Financing -- Costs associated with financing of a construction loan.

Lease Administration -- Administrative expenses associated with leases.

Professional Fees -- Fees for accountants and lawyers.

Permit Fees -- Fees for renewing construction permits.

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Additional soft costs tend to be incurred over the entire length of the delay period. This is the reason the waiting period in the delay in completion form applies to additional soft costs. Additional soft costs consist of:

Interest Payments -- Additional interest payments on the construction loan.

Realty Taxes -- Additional real estate taxes.

Lease Expenses -- Costs related to leases for construction equipment.

Insurance Premiums -- Cost of premiums to renew or extend coverage.

**Rental Income Coverage** - If an insured building is going to be a rental property, coverage for loss of rental income can also be provided. Coverage for rents must be for loss of rental income sustained as a direct result of a covered loss to a covered building. For example, an office building is being erected and the building owner intends to lease out floor space. A loss occurs and completion of the building is delayed because of the loss. Tenants cannot move in and rental or lease income cannot be earned as planned. Rent income that would have been earned, had no loss occurred, will be covered under rental income coverage.

**Income Coverage** -- If a covered building is going to be an income generating property (e.g., retail store), coverage for loss of income can be provided. Coverage for income must be for loss of income sustained as a direct result of a covered loss to a covered building. For example, a store is being built and a loss occurs that delays completion of the building. Income (sales) that would have been earned, had no loss occurred, will be covered under income coverage.

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## Rehabilitation And Renovation Risks

The following is a review of the terminology, exposures, and coverage issues that are associated with rehabilitation and renovation risks.

### Terminology

The terms rehabilitation and renovation are often used interchangeably to describe the restoration, updating, or conversion of an existing building. Rehab is the term most often used to describe any construction on an existing structure. There are two different types of risks involved when a building is being restored, updated, or converted. The key to underwriting this class is to determine what kind of construction work will be performed, and then decide if the risk should be underwritten as a rehab or renovation.

### Rehabilitation Risks

A rehabilitation generally involves the restoration of an old and architecturally unique building, or the adapting (conversion) of a building for a different occupancy, or the restoration and conversion of a building.

Rehabilitation risks are often considered non-standard business because many catastrophic losses have been associated with these risks. Types of hazards that may be present in a rehabilitation risk are:

1. A large accumulation of debris and combustible materials. Many buildings that are rehabilitated are run-down vacant structures that have collected large amounts of refuse, which creates a fire hazard.
2. A great deal of woodworking and cutting may be required. To rehabilitate some buildings, wood stairs and floors may have to be stripped and varnished or even replaced. All plumbing may have to be removed and replaced. An old boiler may have to be cut into sections and removed. The use of open flames and the presence of large amounts of wood and sawdust combine to increase the hazard of fire.

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3. Rehabilitation may require moving supporting walls. To adapt a building to an occupancy not originally intended for the building, structural walls may have to be moved. An engineering miscalculation or construction miscue when changing a wall can result in an unintended shift of the building. The building may then collapse or be condemned and removed.

**Renovation Risks**

Renovation work generally involves updating or remodeling an existing building. Hazards associated with a renovation risk are considered light. A renovation may require only replacing window frames, updating the electrical wiring, drywalling, or minor carpentry work. Most renovation risks are considered standard lines business.

**Builders' Risk or Installation Floater**

When a building is occupied while renovation work is in progress, property insurance for the building may remain in force. If the property insurance for the building is in effect, coverage for renovation work should be written under an installation floater. If property insurance is not in effect, the coverage should be written as a builders' risk policy that will cover the existing building and the renovation work.

**Rehabilitation or Renovation Risk**

To determine if a risk is a rehabilitation or renovation, obtain the following information.

1. age of the building
2. the intended occupancy of the building and the occupancy the building was constructed for
3. the value of the building shell (the existing structure) and the value of the construction work going into the building
4. complete details of the construction work that is to be performed (e.g., updated wiring, replacing plumbing, adding a floor)

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AS A GENERAL RULE, when the value of the construction work exceeds the value of the building shell, the risk can be classified as a heavy (i.e., hazardous) rehabilitation risk. If the value of the work is less than 40% of the value of the building shell, the risk can be classified as a renovation risk.

## **Permission To Occupy**

Coverage under a builders' risk policy ends when a building is occupied. Permission to occupy can be granted by endorsement to allow partial occupancy during construction. When granting permission to occupy, it is important to analyze the exposures that are inherent in the occupancy.

## **Personal Property Coverage**

The builders' risk form only covers property that will become a permanent part of a building or structure. Depending on the coverage form used, coverage for personal property can be extended by endorsement, or it is built into the coverage form as a Supplemental Coverage with a sublimit. Coverage applies to personal property (e.g., furniture or equipment) that will not be permanently installed in the covered building. When extending coverage to personal property, it is important to:

1. make sure the personal property values are reflected in the builders' risk limit
2. analyze any increase in exposures that may result from the introduction of the personal property; for example, has the combustible load been increased or is the property a target for theft

## **Flood Coverage**

Coverage for flood can be provided by adding the Earthquake And Flood Coverage Endorsement. When providing flood coverage, the following information should be obtained and analyzed:

- the Federal Emergency Management Agency's flood zone for the location
- the elevation of the location in relation to the surrounding area
- the history of flooding in the area

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## **Sewer Backup Coverage**

Depending on the coverage form used, coverage for sewer backup:

- can be provided by adding the endorsement for Sewer Backup Coverage; or
- sewer backup coverage is included in the coverage form as a Supplemental Coverage with a sublimit.

## **Earthquake Coverage**

Coverage for earthquake can be provided by adding the Earthquake And Flood Coverage Endorsement. When providing earthquake coverage, the following information should be obtained and analyzed:

- the earthquake zone that has been assigned to the area
- the construction of the building

## **Trees, Shrubs, and Plants Coverage**

Depending on the coverage form used, named perils coverage for trees, shrubs, plants and lawns:

- can be provided by adding the endorsement for Trees, Shrubs and Plants Coverage; or
- trees, shrubs, and plants coverage is included in the coverage form as a Supplemental Coverage with a sublimit.

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## DIC And Contingent Coverage

The Contractors' Reporting Form and Builders' Risk And Installation Floater Form each provide coverage for difference in conditions (DIC) and contingent risks.

**Difference In Conditions** - DIC provisions provide special perils (all risk) coverage excluding fire and other named perils for a builders' risk project. DIC coverage may be required when a building owner agrees to provide basic perils coverage and the contractor becomes responsible for obtaining coverage for all other perils.

**Contingent Coverage** - Contingent builders' risk coverage is sometimes also referred to as DIC coverage. The construction contract between a building owner and the contractor may stipulate that the owner is responsible for obtaining and maintaining builders' risk coverage. Under certain circumstances the owner's insurance may not respond to a loss. Contingent insurance provides special perils coverage that responds when the owner's insurance fails to pay for a loss. The following are instances when contingent coverage would respond to a loss:

- The owner does not live up to the terms of the contract with the contractor and allows the builders' risk insurance to lapse or be cancelled.
- The limit of liability in the owners' builders' risk form is insufficient to cover a loss.
- A warranty in the owners' builders' risk coverage was violated thereby voiding coverage for a loss (this assumes that the same warranty was not a part of the contractors' builders' risk coverage).

Because the term DIC is sometimes used when requesting contingent coverage, it is important to ask which coverage is actually being requested.

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## Green Coverages

It is important to note that green construction is still fairly new and that all hazards and exposures related to green construction may not be known at this time. To date very few claims associated with green construction and green coverages have been submitted. Therefore, at this time there are no "lessons learned" available from claim professionals for this construction and coverage.

**Building Coverage** - With one possible exception, green construction features will not add nor increase any hazards or exposures to a building in the course of construction. This means that the construction techniques and materials associated with green construction will not increase the likelihood of a builders' risk loss. For example, the use of sustainable, environmentally friendly building materials will not increase the potential fire load.

The addition of a green building endorsement to a builders' risk form will not open the door to additional or increased hazards and exposures. However, the additional limits available under the green building endorsement can increase the total amount of a loss.

**Vegetative Roofs Systems** - Green roof technology (vegetative roof systems) can reduce the heating and cooling costs of a building. In general, a vegetative roof system is composed of a waterproofing layer, a soil layer, and a plant layer. The weight (load) associated with soil and plant layers may increase the potential exposure to collapse.

A collapse may occur when the ability of a building to support the weight of the vegetative roof system is incorrectly calculated due to inexperience or error. Collapse can also occur when the addition of the soil and plant layers (and their weight) are applied too soon. Critical roof supports may not be in place or concrete may not be properly hardened (cured) prior to the addition of the soil and plant layers.

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**Delay In Completion And Income Coverages** - The addition of green coverages under a delay in completion form can significantly increase the amount of a delay in completion and/or income coverage loss. A green coverage extension can increase the delay period (period of time completion of the project is delayed) because coverage is provided for the additional procedures and processes associated with the attainment of the building's intended green certification level. For information on levels of green certification, refer to Certification Of Green Buildings in the Information section of this class.

Increases in the delay period can result from delays in obtaining green building materials (e.g. wood from sustainable forests) that are in short supply or that are imported from distant locations. Increases in the delay period can also result from a shortage of green building consultants who are needed for the green certification process.

Green construction features will not increase the potential for a builders' risk loss that results in the delay in completing the construction of a building. However, green coverages under a delay in completion form can add to the length of a covered delay period, and the increased delay period means a bigger overall loss.

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## LOSS CONTROL

The following is a list of possible questions that can be addressed during a loss control survey.

THIS LIST IS NOT INTENDED to represent a comprehensive and exhaustive treatment of loss control issues that relate to builders' risk. UNDERWRITERS SHOULD CONSIDER additional questions that address concerns about specific types of individual risks.

### When to Order a Survey

#### Scheduled Locations

When a scheduled location risk is written, a loss control survey should be ordered three to four months after construction has begun. Any follow-up survey request will depend on the amount of values at risk, the duration of the project, and the advice of the loss control representative.

#### Reporting Form

When coverage is on a reporting form, a survey should be ordered prior to binding coverage. A survey should be ordered for one or two locations only and for projects that are in progress.

### Survey Information

A loss control survey should provide or confirm the following information:

1. What state of completion is the risk in (e.g., excavation state, structural exterior stage, or interior finish stage)?
2. What is the contractors' estimated completed cost of the entire project?
3. Is there a watch service at the jobsite and, if so, what type?

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4. Is the jobsite fenced?
5. What is the town protection class grade at the risk?
6. What is the distance to the nearest fire station?
7. Is the jobsite accessible to the fire department?
8. Is the water supply public, private or non-existent? If private, is it adequate?
9. Are the fire hydrants at the jobsite operable? Have they been tested?
10. What is the distance from the jobsite to the nearest hydrant?
11. Is there a telephone for emergency use within 500 feet of the jobsite?
12. Does the distribution of fire extinguishers at the jobsite meet minimum standards? The minimum standard is one 2A fire extinguisher every 5,000 square feet, with a maximum 75 feet travel distance. Generally this requires an extinguisher on each floor of a multistoried building.
13. Prior to the erection of the roof or floors are exterior walls properly braced to withstand local heavy wind conditions?
14. Are U.L. approved heaters used for temporary heating?
15. Is the jobsite organized in an orderly manner? Is trash allowed to accumulate?
16. Are combustible liquids and gases properly stored?
17. Is a fire watch employed during cutting or welding operations?