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What's the Risk? Understanding Builder's Risk Insurance

BY DAVID B. APPLEFELD

If you are about to begin a construction project, one of the questions you should be asking yourself is "what happens if my work is damaged prior to completion of the project?"

Builder's risk insurance coverage is insurance that is purchased to cover the risk of damage to your work during the construction process. Builder's risk insurance coverage serves a function similar to standard first-party property insurance most people carry, such as homeowners' coverage. This coverage protects

the property from specifically identified perils such as fire.

Often, the project owner or the lender will require builder's risk insurance, and the cost of this coverage can be negotiated or transferred through your construction contract. Even if the owner does not require builder's risk insurance, you should still carry this insurance, particularly where the risk of damage to your work in progress, or the cost of replacing that work is substantial.

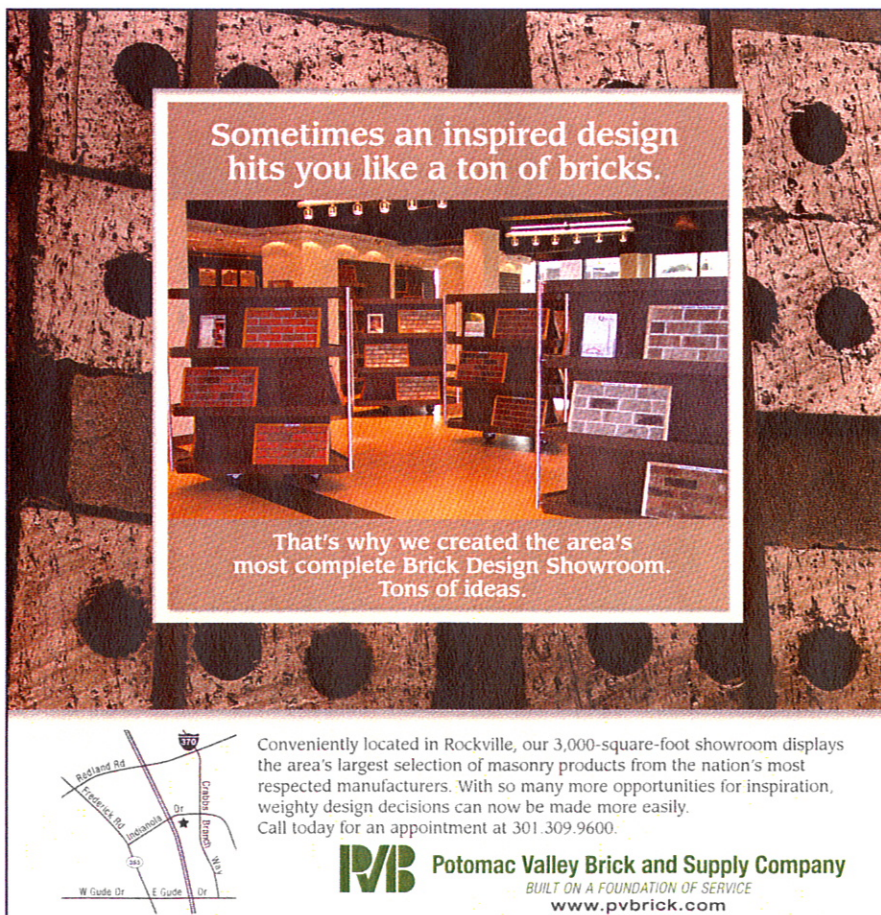
The coverage provided under a

builder's risk policy is designed to reimburse anyone with an insurable interest in the property for accidental damage to that property during the construction process, prior to completion. Typical policies insure against "all-risks" of physical loss or damage to the property, such as damage caused by fire, lightning, wind and hail, water and gas leaks, explosion, smoke, riot, and vandalism.

Builder's risk insurance also covers the costs of building materials and supplies that are intended to become a permanent part of the building while such property is near or within the project area. This includes materials stored on-site during the construction process.

Business interruption insurance or consequential loss/"soft cost" coverage can also be purchased through an additional endorsement to the builders risk policy, or through a separate insurance policy. This endorsement protects the owner and contractor from financial losses incurred when the physical project is damaged during construction. These losses include things such as loss of revenue, loss of investment income, liquidated damages, interest expense associated with debt servicing, loan fees to extend or renew, real estate or property taxes, architect and engineer fees, insurance premiums to continue coverage, as well as legal, accounting and other professional fees.

Endorsements available under the builder's risk policy can also be purchased to cover materials or equipment in storage or transit (a moveable property floater) and to provide coverage for subcontractors' work in process (an installation floater). Other specialty endorsements are particularly important when



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the contractor is responsible for specific types of property during installation, such as compressors or other machinery, which are not covered by the standard builder's risk policy.

Under most form contracts, such as the AIA A201-1997, the owner is required to procure an "all-risk policy" in the amount of the total value of the project, or on a replacement cost basis. The insurance required under the A201 contract must include the interests of the owner, as well the contractor, the subcontractors and the sub-subcontractors. If the owner elects not to purchase this insurance, the owner must notify the contractor. The contractor may then purchase the coverage and include the cost in a change order to the owner. An owner who fails to procure builder's risk insurance or notify the contractor of this fact is liable to the contractor for damages that would have been covered. In addition, under the AIA A201 contract, the owner must pay the costs which are subject to a deductible.

Most standard construction contract forms contain a waiver of subrogation provision through which each party waives the right to recover damages against the other for losses covered by insurance. Because some insurers prohibit these types waivers without consent of the insurance company, it is important for the party purchasing the insurance to notify the insurer if the construction contract contains such a clause.

Finally, like all other types of insurance, builder's risk policies have certain exclusions that either limit or eliminate coverage. Typically, builder's risk policies exclude losses resulting from faulty design or faulty workmanship. Because the exclusions will vary from policy to policy, it is important that you review the policy with your insurance agent or your attorney so there are no surprises. ■

Mr. Applefeld is a member of the Law Firm Adelberg, Rudow, Dorf & Hendler, LLC whose practice concentrates in the area of construction law. If you have questions about the topic of this article or other legal matters, Mr. Applefeld can be reached at 410-539-5195 or dapplefeld@adelbergurdow.com.



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