Course of Construction Insurance Basics

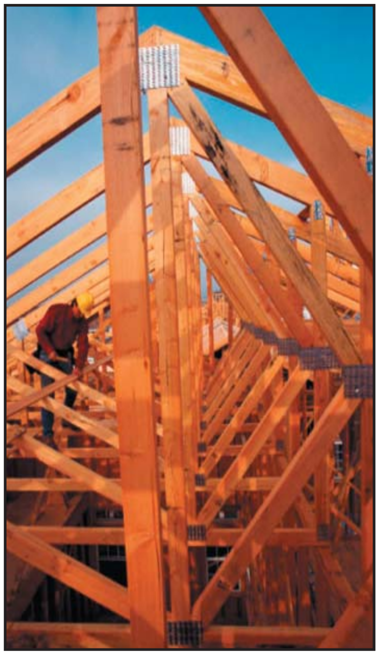
INTRODUCTION

For insurance policies that are intended to cover financial losses that occur during the course of constructing a building, insurance companies must look at a number of issues in order to provide their best rates and conditions of insurance for the building professionals (builders, owners, designers, contractors and construction project managers) involved in the project. The goal of all the parties involved is to obtain the broadest insurance coverage, at the lowest costs, while ensuring minimum risk during the construction work.

WHAT YOU NEED TO KNOW

Types of Insurance Policies

There are a number of insurance policy types available to cover losses arising from operations related to the construction of a building. Some particular forms and inclusions or exclusions are more common to either residential or commercial construction projects.



Property Insurance:

'Course of Construction' (CoC) (also called 'Builders Risk') – A specifically-designed form of property insurance. It provides fire insurance, including extended coverage for risks such as windstorm and optional coverage for events such as floods and earthquakes, for losses that might arise as a result of operations related to building construction. It can also prescribe exclusions that specifically relate to those operations. Most Builders Risk policies are issued based on 'broad form' coverage. During construction, this form provides 'all-risk' coverage for fire and vandalism, as well as 'in transit' coverage. If flood or earthquake coverage is desired, these usually must be added by endorsement for a specific premium.

Liability Insurance:

'General Liability' (GL) and 'Comprehensive General Liability' (CGL) – The two most common forms of liability insurance. Most builders purchase a CGL policy, which includes coverage for any bodily injury or property damage occurring as a result of their products, operations and completed operations. CGL policies are so broad that they can include coverage for other related exposures for the insured operations, including coverage for the owners and contractors, personal injury, medical payments, broad form property damage, as well as coverage of 'Contingent Employers Liability' (also called 'Stop Gap' insurance).

'Environment Impairment Liability' (EIL) – A form of liability insurance that is becoming more common. Provides coverage for the 'Pollution Liability' imposed on the Contractor/Owner due to any pollution of the environment that occurs as a result of the construction operations. Examples include: seepage of chemicals produced or used during the construction operations into an adjacent underground area or body of water such as a lake, pond or stream; and, release of chemicals into the air as a result of a major fire at the construction site. The EIL policy normally provides coverage for 'Sudden & Accidental' pollution, including on-site third-party bodily injury and property damage, as well as off-site third-party bodily injury, property damage and cleanup costs, arising from pollution conditions on, or emanating from, the covered construction site.

'Wrap-up Liability' – Intended for large construction projects, to provide general liability coverage for the general contractor plus all sub-contractors under one policy for a specific project.

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> A list of insurance brokers that are experienced and knowledgeable about wood projects is currently being compiled. For more information, please contact the Canadian Wood Council.

Selection of Insurance Broker and Insurance Company

The selection of an insurance broker and insurance company can be very important. "Comparative shopping" for the broker that is best suited to a project can often result in better premium rates.

- The broker should be experienced and knowledgeable in handling similar types of business. An experienced broker will know exactly what information the insurance companies are looking for and which insurance companies to approach for a cost quote.
- The broker's company should be large enough so that they have contact with a number of leading insurance companies that write all types of business.
- A leading insurance company that is financially sound and experienced will provide the right forms and coverages and will know how to handle claims in a professional manner, because they have the necessary experienced staff and legal resources.
- When comparing rates, make sure that the comparisons are "apples to apples" as much as possible, since each insurance company will have its own "standard" inclusions and exclusions in their insurance policies.

Factors That Impact Insurance Policy Costs

As with post-construction property insurance[1], there are a number of factors that can impact the final rates used to determine the total premium costs quoted by an insurance company (the 'Insurer'). The company/individual responsible for the design and/or construction of the building (the 'Insured') has little or no control over what is termed the 'base rate' used by an Insurer. The base rate is assigned on the basis of the general industry experience or 'loss history' for that specific province or area of the province, as well as the specific location, type of construction, and intended use and size of the completed building.

However, this base rate is typically modified based on certain other criteria that the Insured can influence in order to reduce the final rate quoted by the Insurer.

Insurers will quote their best rate when they obtain complete underwriting information that increases their comfort level that the risk is "above average" in terms of safety, and that the Insured is experienced, knowledgeable, cooperative, safety-conscious and will take all necessary steps to prevent or minimize losses.

The Insurer will typically favor an Insured that obtains/has:

- 'Hold-harmless' agreements – a 'hold-harmless' agreement helps the Insured minimize their exposure and risk of responsibility for any loss that is the fault of a sub-contractor, who may or may not have the proper insurance coverage or limits for their operation.
- Certificates of insurance from sub-contractors – obtaining certificates of insurance indicates insurance coverage of sub-contractors, which limits an Insured's risk exposure to any loss that is the fault of a sub-contractor.
- Architects/designers on the project who carry 'Errors & Omissions' (E&O) Professional Liability insurance – E&O Professional Liability coverage of architects/designers on the project reduces an Insured's risk under their CoC coverage.

Additional factors that can be used in negotiations to enable the insured to obtain lower rates on a policy include:

- Acceptance of higher deductibles – this shows that the Insured is willing to share greater responsibility in case of a loss.

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- Compliance with loss-control and underwriting recommendations – this indicates that the Insured is willing to work with the Insurer to improve the risk.
- Placement of multiple policies with the same Insurer (for example, general liability and automobile) – this reduces the Insurer's concern regarding overlapping of exposures, and the Insurer may offer a volume discount. This may also assist at the time for renewal of the policy - the Insurer might look at the overall account profitability rather than considering the loss experience of only one policy.

> Provide as much information as possible so that the insurance company is not placed in a position where they are making assumptions. A knowledgeable insurance broker can assist in this.

The greater the amount of positive information provided by the Insured, the higher the probability of obtaining the best insurance rates and terms. This includes providing a fully completed application, giving all the pertinent details requested.

The Insured should include:

- a list of all site safety controls that are/will be in place, for example those related to material storage, waste handling, 'hot work', and site security[2];
- a copy of the company's risk management policy/program[3];
- details of past 'claim-free' experience with similar projects;
- a complete, detailed loss history for the last three to five years; and,
- details of Insurers of previous policies.

Limits of Liability

It is important that an Insured ensure that they are not over-insured in some areas and under-insured in others. To do so, the Insured must review their whole insurance program to determine that they carry adequate policy limits and coverage. For example, in addition to coverage of building value in the event of damage or loss, cost of cleanup of a site and debris removal after such an event should also be included.

Some specific aspects that need to be considered:

- Co-insurance Clauses – the project should be fully insured for the proper values so that there is no 'co-insurance' issue with any loss that occurs. A co-insurance clause in a policy requires the Insured to carry a certain percentage, usually 80, 90 or 100 per cent, of insurance in relation to the value of the insured property. In the event of a claim, failing to meet the co-insurance clause requirement requires the Insured to bear a proportion of the loss: i.e. to become a co-insurer.
- Third Party Liability – the Insured should consider obtaining similar limits for both general liability and automobile policies that have third party liability. This can help avoid overlapping of liability exposures, especially in the case of vehicular

Co-insurance Clause Example

Building Value	$1,000,000
Co-insurance Clause	x 90 %
Require Insurance Coverage	$900,000
Actual Insurance Coverage Carried by Insured	$450,000
Therefore,	
Insurance Company Coverage	$450,000
Insured's Co-insurer Amount	$450,000
Ratio of Co-insurance (applicable to all loss amounts)	**50:50**
In Event of Actual Loss of	$100,000
Policy Deductible	- $10,000
Payable Loss	$90,000
Insurance Company Percentage (from Ratio of Co-insurance)	x 50 %
Insurance Company Payment	$45,000
Actual Loss	$100,000
Insurance Company Payment	- $45,000
Balance of Actual Loss Borne by Insured	**$55,000**

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QUICK FACTS - INSURANCE AND CONSTRUCTION SERIES

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loading/unloading losses or a loss as a result of the operation of machinery attached to an automobile. Having the same insurer providing the coverage for both policies helps to eliminate any dispute after a loss. Adding the necessary endorsements to the automobile policy can also help to make sure there is no confusion.

- Umbrella Policies – umbrella policies are designed to provide excess coverage over and above the general liability and automobile policies, and provide coverage for unknown liability exposures. The limits that should be carried in order to have proper coverage on these policies depend on the size and type of exposures. Important questions include:
  - Is the project large in terms of receipts, number of units and duration of project?
  - Is the project a residential or commercial, low-rise or high-rise building?
  - Is the project new construction, or a renovation or addition to an existing building?
  - Is the project located in an urban or rural setting?
  - Is the project exposed to hazards from adjacent properties?

Examples of additional risks of losses for which an Insured may want to consider coverage are[4]:

- Business interruption – loss of revenue/income as a result of delay in completing the project due to a loss caused by a covered peril; this is often added to the property policy by endorsement.
- Crime – also referred to as "3-D", which stands for loss of money due to "disappearance, destruction and dishonesty".
- Delay penalty – penalty levied due to delay in meeting the project deadlines; coverage for this is called a "Surety" policy.
- Fraud or deceit – loss due to fraudulent induction of an Insured to part with covered property.
- Contract penalty – penalty for non-completion of the contract assessed against the Insured; however, an Insured's inability to complete the contract according to its terms must be the direct result of a loss by a covered peril.
- Testing – loss to a building caused by a covered peril that results from testing of materials, machinery, or equipment that will become a permanent part of the building or structure (including startup, performance, stress, pressure or overload testing).
- Property in transit – damage to or loss of materials/machinery used in construction that during the project might be in transit or in storage off-site.
- Soft costs – additional expenses incurred by an Insured when construction is delayed by a loss caused by a covered peril, e.g. additional attorney's or accountant's fees, additional interest payments on construction loans, additional architectural or engineering fees, additional insurance premiums.

FOR MORE INFORMATION

The Canadian Wood Council offers building professionals free technical support services throughout Canada. New information regarding insurance-related issues continues to be collected. Please visit the Canadian Wood Council's web site at www.cwc.ca for more information.

This information is for general reference and guidance only. The insurance industry in Canada is diverse, complex, and constantly responding to changes in the marketplace. The information provided should not be considered exclusive, nor inclusive of all information available on the topics presented. The Canadian Wood Council does not assume any responsibility for the completeness of the information presented.

1. See CWC publication entitled "Fire Safety and Insurance in Commercial Buildings" at www.cwc.ca for more information.
2. See companion Quick Facts No. 3 in the Insurance and Construction Series, "Course of Construction – Site Risk Control Guidelines", for more details on this topic.
3. See companion Quick Facts No. 2 in the Insurance and Construction Series, "Course of Construction Risk Control", for more details on this topic.
4. Prahl, Robert J., "Course of Construction Insurance: Some Important Considerations" American Association of Insurance Services Coverage Perspective, September 29, 2004; www.aaisonline.com.