Rough Notes®

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FLORIDA SPECIAL REPORT 2022

NAVIGATING BUILDERS RISK MARKETS

Eight tips for successfully guiding clients to the best protection

By Christopher Reid

Building a high-value home can be an exciting endeavor, but such projects also come with considerable risk. It's essential for agents to understand the risk markets so they can advise their clients on how best to protect their investments.

For example, while the Florida wind season spans just a portion of the year, the state is considered a year-round CAT market with multiple perils that warrant attention. If your client wishes to build a new ground-up high-end home in this state, they'll need their contractor to take certain precautions.

For instance, it is imperative to use the best materials (doors, windows, roofing) and construction techniques. The goal is to minimize property loss and to mitigate the effects of wind, which can be a game changer when it comes to hurricane damage.

Here are eight key considerations for agents in Florida and beyond:

1. Understand lender requirements. If your clients take out a loan for the property and/or project—as most people do—they must comply with the lender's requirements. Florida is a price-sensitive market and clients often gravitate towards the least expensive premiums because policies to insure high-end homes can be expensive.

Advise your clients to look beyond the price point and instead focus on having proper coverage. For example, perhaps your client is trying to choose between a 5% or 10% wind deductible. In many cases, the bank won't allow the 10% wind deductible option, so that's not a feasible option. The client may in fact not even consider their self-insured exposure with the deductible. With a multimillion-dollar home, 10% may represent much more than they are willing to absorb.

Understand what each client's lending institution requires and advise them accordingly.

2. Secure multi-year coverage. There are markets that offer policy terms up to 36 months, which is typically a better choice than getting a policy that must be renewed each year. For most high-end homes—in catastrophe-prone areas like Florida where it's important to protect against hurricane damage—it is prudent to advise your client to get multi-year coverage. Fortunately, high-end home projects are eligible for this option.

Keep in mind, however, that annual renewals come with risks. There are times that an insurance carrier loses its appetite for builders risks. If that happens before your client's annual policy is up, the carrier will not renew. As a result, the client will then encounter a new set of problems, as other carriers typically don't want to get involved in a mid-term construction project. And if you do find another carrier to cover the project, rates will likely be significantly higher because mid-term construction projects have more exposures for replacement carriers to cover.

Help your clients avoid these issues by securing a multi-year term at the start of their project.

3. Consider other types of insurance. The most expensive causes of construction losses over the past five years

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were fire and explosion incidents, which reportedly accounted for more than a quarter (26%) of claims; natural hazards drove 20% of the claims.

It's possible that the insured will need additional types of insurance, especially if the lender requires them. In a CAT-based market like Florida, there are often lender requirements to cover flood exposure; however, not all carriers offer flood. If the original policy doesn't include flood coverage, the insured may be required to purchase a separate policy—at an additional cost—to satisfy lender requirements.

Build location may affect what types of insurance are necessary. For example, constructing a home on the beach in Boca Raton will likely require flood coverage, but a home in the middle of the state—like in Orlando—might not. Consider other types of coverage your clients may need, including earthquake, wildfire, theft of building materials, non-flood water damage, wind, etc. While the wildfires in California and Colorado have been making national headlines, there's exposure in every state, as evidenced by the recent fire in Panama City. Wildfire and other coverages are critical in certain locations, even if it isn't required by the lender.

Private client retail agents should advise their clients about whether they need additional coverage and, if so, what types.

4. Be clear on waivers of subrogation. Insurance advisors must perform due diligence to fully understand insureds' contracts with their builders; of particular importance are waivers of subrogation. If the insured has signed a contract and the builder inserted a waiver of subrogation, it means that if something goes wrong with the project, your client is waiving their rights to sue the builder.

This is important in placing the risk in the market because many carriers won't write a policy if a waiver of subrogation is in place. In fact, there's often exclusionary language in builders risk policies that assumes that a waiver of subrogation *isn't* in place. If there is a waiver of subrogation in place, it must be disclosed to the underwriter, so that it's rated and approved by the carrier.

If the question isn't asked up front and a policy is bound, there will likely be gaps in coverage.

5. Consider possible disruptions/delays. Here's another example of why a multi-year policy term is critically important. There can be numerous causes for project delays, including supply chain disruptions, staff shortages, and weather events.

The increased complexity of some construction projects—along with new sustainability guidelines—can also lead to setbacks. Post-COVID supply chain issues have been disrupting the new construction market, with increased costs for materials as well as delays in receiving those products from vendors. As a result, a project that should have taken 18 months to complete may now take two years or more. A multi-year term policy will cover the insured in case of delays, whereas an annual plan likely won't.

If your client doesn't have longer-term coverage in place and encounters delays in the project, they will have to extend their policy or potentially remarket it mid-term, (as was said) can be problematic and more expensive.

6. Be mindful of sustainability efforts. The goal to move towards a net-zero society means transitioning to more modern building methods, using cleaner materials and processes.

Complying with new sustainability regulations can lead to additional challenges. Timber, for instance, is a sustainable and cost-efficient material, but it has implications for fire and water damage risks. Also, whenever builders choose new methods or materials, there's a learning curve and potential risks associated with this lack of knowledge and experience.

7. Disclose a minimum earned premium (MEP). Even when clients are building a high-value home, they may want to shop around for the least expensive insurance policy. Suppose your client binds a fully earned, two-year policy for $50,000. If the builder happens to finish the project early—in just 18 months instead of 24—the insured should understand that there's no return on their premium. In other words, they won't get reimbursed for the "extra" six months after the project's early completion, and their agent must disclose that.

This is yet another reason why insureds need to work with insurance experts who can guide them through these issues.

8. Know that similar rules apply for commercial builds. The same carriers will offer terms for true ground-up commercial construction properties, for new apartment buildings, condominium projects and mixed-use buildings. The same underwriting practices apply for these projects.

Most important

Above all, provide sound advice. Retail insurance agents who specialize in the high-end private client market should educate themselves on all the issues involved in the builders risk market in order to more skillfully counsel their clients.

As part of these efforts, agents and brokers should be aware of how recent legislation impacts the builders market and work with carriers that can evolve with those changes. It is wise to work only with A-rated carriers or better, as markets without the A rating may offer substandard coverage. Collaborate with underwriting partners that understand the marketplace to help guide clients towards the most appropriate coverage.

Also, keep in mind that agents and brokers can give the best advice but it's ultimately the client who decides which policies to purchase. ■

The author

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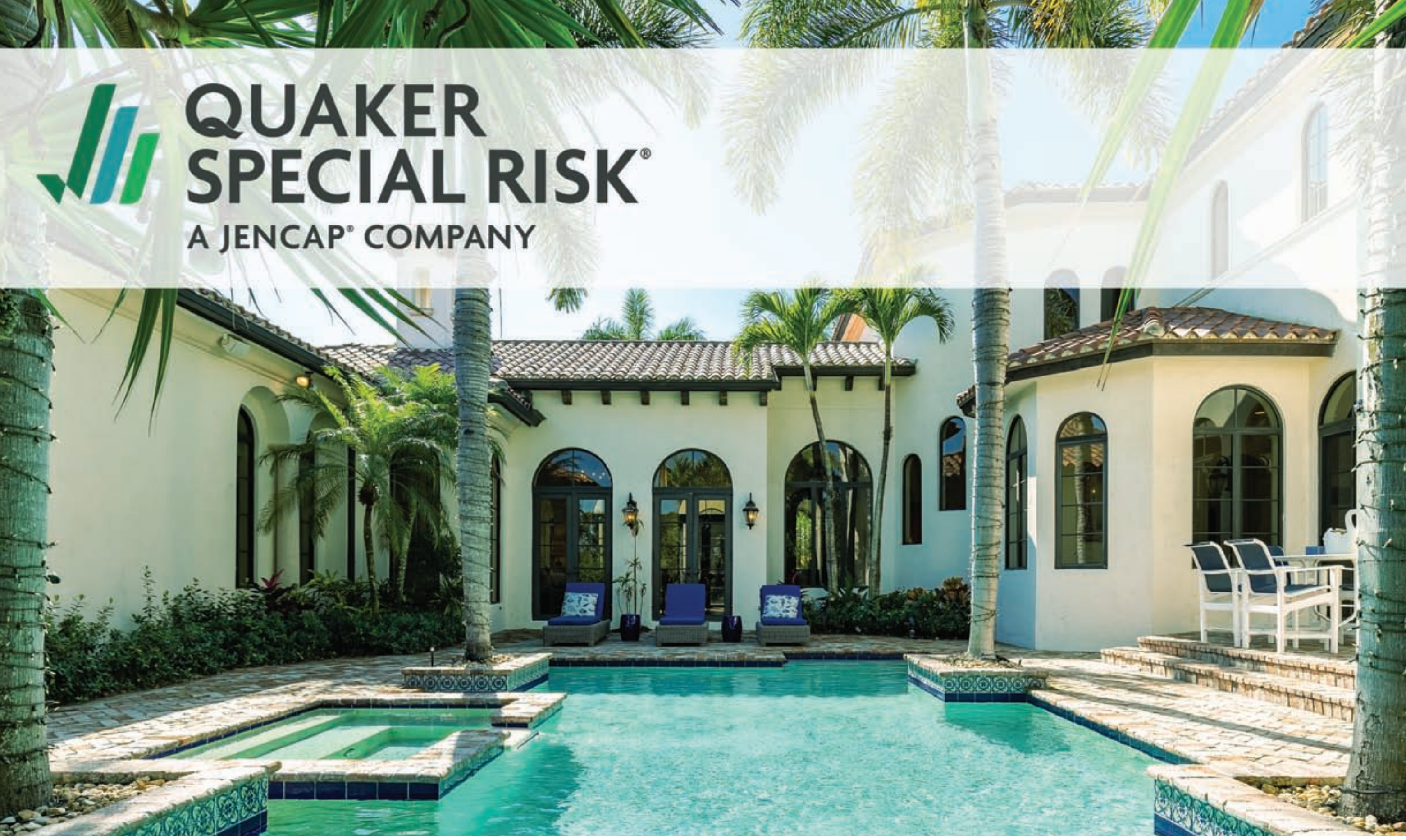

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