

# How To Buy Construction Insurance

by Peter Hood



Most builders buy general liability and workers comp insurance from the same company. While there is no reason to change this strategy, the rapid increase in workers comp rates has changed the way insurers sell construction insurance, and the way builders shop for it.

There are still two primary markets for workers comp insurance: the voluntary market, and the assigned risk pool. In the voluntary market, insurers can decide whether to underwrite policies based on the track record of each construction company that applies. Insurers have no choice, however, when it comes to the assigned risk pool. Builders in this category are either engaged in dangerous work, such as blasting or mining, or have a poor claims record. No builder in the assigned risk pool can be denied insurance.

Years ago, rates were the same for companies in both the voluntary market and the assigned risk pool. The major difference was that voluntary market policies offered several different plans to spread out premium payments, while assigned risk premiums had to be paid up front. Today, policies in both markets use payment plans, but assigned risk pool premiums are higher than those in the voluntary market.

Losses are also handled differently, depending on which market the policy is written for. Insurers must cover all losses from the policies they write for the voluntary market. That's why they insure only companies with a good track record. Losses in the assigned risk pool, however, are spread among all insurers who sell policies in the voluntary market. This protects a single insurer from having to bear the full cost of the individual high-risk policies it writes.

Even so, the assigned risk pool runs a deficit. In many cases, assigned risk losses account for as much as 20% of premiums charged for policies in the voluntary market. The reaction of insurance companies has been to reduce the number of work-

ers comp policies they write and to charge higher premiums for them.

**ARAP.** Unfortunately, the higher premiums caused by the assigned risk deficit raises workers comp premiums for everybody, even builders in the voluntary market who have good claims records. A new program called the Assigned Risk Adjustment Program (ARAP) aims to make the assigned risk pool self-supporting by charging higher premiums to builders with poor claims records. Under ARAP, builders with an experience modification rating higher than 1.0, and who meet other criteria (such as consistently high premium costs) will receive an ARAP charge on top of their regular assigned risk premiums (actual criteria vary from state to state). This can result in premiums as much as twice the normal rate. While ARAP is relatively new (about half the states have it now), the National Council of Compensation Insurers (NCCI) is trying to institute ARAP in all states.

How does ARAP affect the way builders buy insurance? Obviously, the most important factor is to find an insurance carrier who will write your workers comp insurance in the voluntary market. For new carpentry contractors with no track record, this may be difficult. That's because construction traditionally has some of the highest claims rates, and insurance companies are gun-shy about newcomers. The best strategy is to shop around. If you can't find a voluntary market policy, find the best deal you can for an assigned risk policy. Then use safety policies and employee education to keep your claims low, and shop around again next year. After two or three years with a clean record, chances are good you'll find an insurer in the voluntary market to write your policy.

**General liability.** In most cases, workers comp insurance determines the buying strategy, and general liability

insurance is of less concern. There are exceptions, however. Some contractors (roofers and blasting contractors, for example) are in higher risk classes, so their workers comp insurance is always written in the assigned risk pool. This leaves only general liability insurance to dicker over.

Buying general liability insurance is not as difficult as it used to be. Broad form coverage, which used to be optional, is now standard for most policies. In a broad form policy, a general contractor's liability insurance covers claims caused by the work of subcontractors. This is important "fine print," however, so it's still worth asking your agent if your policy includes broad form coverage.

In fact, it's always smart to ask questions when buying insurance. Ask your agent questions about how your liability policy actually works. Did you know, for instance, that even a broad form policy does not cover defects in workmanship, regardless of whether the work is done by a subcontractor or by your own employees? For example, if a plumber installing a new shower head gives his wrench one turn too many and breaks off the shower head, damage to the fitting he was working on is not covered. On the other hand, the policy probably does cover damage to the tub when the shower head falls and chips the finish. Similarly, if your employees install a new roof and it leaks, your liability insurance will not pay to repair the roof because that is your work product. Insurance will, however, pay to repair drywall and wallpaper damaged because of the leak.

**Policy limits.** Also ask about policy limits when buying general liability insurance. A typical one-man outfit should buy limits of \$500,000/\$1 million (per-occurrence/aggregate). Higher limits are available for most trades, but contractors engaged in dangerous work (such as roofing, blasting, and installing gas lines) will pay higher premiums for higher limits. A jump to \$1 million/\$2 million, for instance, might increase premiums by 15%. The good news is that you can increase your policy limits for a particular job at very little extra cost. When the job is over, simply reduce the limits back to normal levels.

**Builder's risk.** Many large damage claims, such as collapse or fire, are cov-

ered by a standard homeowner's policy. A building that is still under construction, however, should be protected with a builder's risk policy. In addition to covering the structure itself, builder's risk insurance also protects against loss by theft or disaster of materials stored on site (such as windows) that have not yet been incorporated into the building. Make sure the policy limits cover the value of the work you are doing. Most contractors prefer to buy the policy themselves, because in the event of a claim, the person who owns the policy is the person who gets the check. The next best thing is to purchase a policy jointly with your client, so that any claims checks require signatures from both parties.

**Inland marine.** I also recommend insuring your tools with an inland marine policy. This type of insurance will cover your tools wherever they are: on site, in your truck, or stored in your shop. Watch out for a "locked vehicle warranty," however, which doesn't protect tools stolen from an unlocked vehicle. This shouldn't make too much difference, however, since most builders use common sense and lock up their trucks if there is any danger of theft.

Likewise, you should use common sense even if your insurance policy doesn't have such a stipulation. If you store tools on a wide-open site, your policy may cover the loss — but only the first time. The insurer will probably refuse to write a second policy, and other companies will not look favorably on this type of claim.

The same is true of the other construction insurance you purchase. Insurance coverage is not an excuse to be careless. Your policies may cover your losses the first time something goes wrong, but every strike against your record makes insurers less likely to renew your policy. A poor claims record also tends to increase your premiums. Buying the proper insurance is a good first step, but using common sense is the only sure way to keep costs down and maintain a clean track record. ■

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