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Product Fact Sheet – Construction Insurance

What is Construction Insurance?

Construction Insurance (sometimes referred to as Contract Works or even just Works insurance), is designed to cover the physical damage or loss to a building, whilst in the course of construction.

In addition, it is possible to insure any public liability risk associated with that construction (where the builder does not already have in place an annual public liability policy).

Construction insurance policies can be issued for a specific contract or an annual policy covering multiple contracts. Generally, professional builders take annual policies where as owner builders tend to effect a specific contract policy only.

How is my premium calculated?

For a specific contract, the policy period can run for any time from 3 months to 36 months. The premium charged is calculated based on the total contract value, not the period of cover. In the event, the construction is complete before the expiry of the policy, no refund of premium is due.

For annual policies, premiums are calculated on one of two methods:

1. The total value of contracts started within the policy period, or
2. The total value of contracts completed within the policy period.

The first section of cover under a Construction Insurance policy is referred to as the “Material Damage Section”. This section covers the actual building for rebuilding costs against fire, storm damage, vehicle impact, lightning damage, and explosion. It does not generally cover flood insurance; however some insurers may be prepared to add this for an additional premium.

What extra covers can I purchase?

The Material Damage section can also be extended to cover other costs that may be incurred as a result of a claim –

- Builders tools and equipment and unregistered plant used on the job site
- Extra costs for professional fees
- Escalation costs – extra costs with rebuilding as a result of the claim – i.e. material costs may have increased or changes in local government regulations may require changes to the structure when rebuilding.
- Costs for removal or debris
- Costs to rebuild existing structures that are part of the contract – i.e. additions or extensions (more on this later in this information sheet)

Under-insurance:

Under-insurance is the situation that arises when your sum insured is less than the total assessed replacement or rebuilding cost of property that was damaged or lost. Underinsurance affects buildings, contents, stock, plant and equipment, tools of trade and loss of gross profit, and also materials and buildings during the course of construction, which occur as a result of a fire, storm or the like. Most business and home policies will penalise you by reducing your claims settlement if you have taken out insufficient sum insured.

What happens if I under-insure:

If you are under-insured, you might be in for an unpleasant surprise if you ever need to make a claim. Even in situations of partial claim or loss, it is likely that you will be deemed to be carrying a percentage of risk and you will not receive a complete pay out. Business and home policies have one of the highest incidences of under-insurance and it is estimated that over 70% of policies have some form of under insurance.

To show the impact of under-insurance, we include the following example based on a policy with 80% co-insurance:

Adjusted Loss = (Declared / Value) x Loss

If insured for \$500,000 and the value at risk was \$1,000,000 with a loss of \$200,000, the claim would be adjusted as follows.

Adjusted Loss = (\$500,000 / \$800,000) x \$200,000

Adjusted Loss = \$125,000 - In this example, the uninsured loss would result in a \$75,000 lower payout.

Public and Products Liability Insurance

The Liability section of the policy mirrors the standard public liability insurance cover that any builder would take out. It covers injury or death to third parties, or damage of loss to their property, as a result of a negligent act or omission on the part of the builders and their staff.

As with most liability insurance policies, you will select a sum insured (say \$5,000,000) and this will be the cover provided for each and every loss that arises from a negligent act or omission. However, for claims that arise from the failure of a product you use or install (i.e. a kitchen cupboard hinge fails and the door falls on the head of the owner, the cover is limited to the total sum insured for all claims during the period of insurance.

Note it is very important to ensure that the Liability section of the policy extends to cover injury or death to third parties, or damage of loss to their property, as a result of a negligent act or omission by sub-contractors employed to work on the site.

TIP: Builders – always make sure your sub contractors have their own public liability insurance, workers compensation insurance and tools insurance – don't take their word for it – get a copy of their certificates of currency and make sure they are issued by the insurance company on the insurance company's letterhead.

Material Damage cover for existing structures

Insuring existing structures (for their entire value) for a nominated amount, under the material damage policy, removes a risk for the building owner. Most home and commercial building insurance policies will continue to provide cover to an existing building that is undergoing additions or renovations, provide the value of the work is below a set limit (each insurer has different limits). Most home policies will allow work up to \$50,000. Some insurers will increase this limit for building owners on request.

If a claim occurs purely as a result of work being undertaken – i.e. a storm tears a hole in a temporary roof sheeting and water gets in causing damage to the existing part of the home or contents, then this sort of risk would automatically be covered if the existing structure is insured under the Construction policy. Likewise, if the builders failed to tie down the roof sheeting properly and a storm causes it to blow open, again this would be covered.

However, if the existing structure is not insured under the construction policy and the builder relies on the property owner to have informed their insurer of the work going on, this could, either of the above examples could result in an arguments as to who was responsible and who should pay the claim. The last thing a building owner needs when water is pouring in through their roof – is an argument about who is going to pay to fix it.

Heritage listed buildings are a particular concern – they are often required to be declared by construction insurers. Old buildings were constructed without the benefit of strict building codes and performance designs. They have invariably deteriorated over time. Like-for-like Materials can be hard to obtain, often expensive, or indeed are unobtainable and such structures are more susceptible to damage by vibration, fire and water than modern structures. Accordingly, replacement values can be very unreliable even those obtained from experts!

So even a partial damage could result in the entire existing structure having to be replaced.

TIP: Builders – always make sure your client has informed their home or building insurer about the extension or renovation and get a copy from the insurer, confirming this. If you can't get this and the value of the total contract is going to exceed \$50,000 – make sure you insure the existing building under your Construction Insurance.