

CONSTRUCTION INSURANCE KNOW-HOW

08 PRE-EXISTING PROPERTY

INTRODUCTION

At SURA our underwriters are often asked to cover Pre-Existing Property under a Construction Insurance (CI) policy. In the world of construction insurance, Pre-existing Property cover can be confusing and is generally a coverage gap that is often missed in the terms of the building contract.

This edition of "Know-How" helps explain the extent of coverage under the SURA policy, how it works in practice and how SURA's innovative approach can help you, our broker, and our mutual clients.

A TYPICAL SCENARIO

Your client, Joe Blogs Building Company Pty Ltd (JBBC), has recently won a contract to add a 2nd storey extension onto an existing house owned by John Smith.

A contract has been signed between JBBC and John with a construction cost (Contract Value) of \$250,000 to construct the 2nd storey extension.

John currently holds a Home Insurance policy covering the existing house for a replacement value of \$300,000. The Home Insurance policy contains a condition which has the effect of voiding cover when a major extension or renovation is undertaken.

The contract contains a condition effectively making Joe responsible for arranging insurance for the whole of the existing dwelling.

TYPES OF COVER SURA PROVIDES

Pre-existing property cover is given by endorsement to a CI Policy. SURA can provide two levels of cover:

E-102 Pre-existing Property (Section 1) Limited cover (Version: SURACIE102JUL15)

We will indemnify the Named Insured against an Insured Event to Pre-existing Property on the Project Site which is in the Insureds care, custody or physical or legal control provided that such loss or damage

- (a) arises out of the performance of construction works, and
- (b) occurs and is discovered during the Period of Insurance.

What does it mean?

This endorsement provides a cover on a limited basis, which means SURA will only indemnify a loss to the Pre-Existing Property that arises out of the performance of Construction Works.

From the Scenario, if Joe Blogs was in the middle of putting up the wall frames for the 2nd storey and accidentally broke a water pipe

which damages John Smith's existing property, then the endorsement will likely indemnify that loss, depending on the circumstances.

E-103 Pre-existing Property (Section 1) full cover (Version: SURACIE103JUL15)

We will indemnify the Named Insured against an Insured Event to Pre-existing Property located on the Project Site which is in the Insured's care, custody or control, provided that such loss or damage occurs and is discovered during the Period of Insurance.

The amount paid under this Endorsement will not exceed the Sum Insured stated in the Policy Schedule for Pre-existing Property for any one Indemnifiable Event.

What does it mean?

This endorsement provides the Insured cover against an Insured Event to Pre-existing Property from both construction activities and other perils.

From the Scenario above, if Joe Blogs had this coverage and he was in the middle of putting up the wall frames for the 2nd storey and a bush fire burns the Pre-existing Property to the ground then the policy will respond and cover the damages to the Pre-existing Property and the construction work as well.

HOW DOES SURA'S COVER WORK?

Builders that often undertake extension or renovation works on dwellings need to clarify insurance of the existing property. Owners will likely not understand that coverage under their home building policy voids whenever major construction work takes place.

Applying an automatic sub-limit under an annual policy can lead to uninsured loss as it promotes misunderstanding and a false sense of confidence in the builder that their CI policy has the coverage. In accordance with the principle of utmost good faith it is the underwriter's responsibility to prevent misunderstandings about the extent of cover provided. For this reason SURA believe that coverage for existing property is best dealt with on a case by case basis.

Consequently projects requiring full coverage for Pre-existing Property coverage (**E-103 Full cover**), must be referred to SURA at the time so as to make sure the correct amount cover is provided. This is done by individual endorsement. In this case the premium amount for Pre-existing Property should be passed back to the owner (John in the above scenario) who will be eligible for a pro-rata refund from his home building insurer as the home insurance policy will be voided during the construction phase.

For Single Policies whether it is limited or full cover, premium is collected at inception.

In our scenario Joe would need to arrange for E-103 Pre-Existing Cover Full cover and SURA would charge a premium for the cover.

RISK MANAGEMENT TIPS

What things could you do to better understand which type of CI policy best suits your client's needs?

It is important to check a few things before enquiring about Pre-existing Property cover.

- **Who is contractually responsible to insure the Pre-existing Property?**

There are times when the builder is not contractually responsible to insure the Pre-existing Property. In the scenario above it is best to confirm whether Joe Blogs is contractually responsible for John Smith's existing house.

- **Does the home insurance remain active during the Construction Period?**

Depending on the insurer, most home insurance will allow for a certain amount for construction works to be done while the policy remains active. This means the home insurance will respond to losses subject to the insurers' terms and conditions.

In the scenario above it would seem clear that the Home Insurance policy will be voided. This means that Pre-existing Property i.e. John's existing house will not be covered at all by his home insurance policy and will need to be fully insured under the CI policy.

If the Contract Value was less than \$100,000 then the home insurance would have continued and Pre-existing Property cover under the construction policy would not be required.

- **Confirm replacement value of the Pre-existing Property**

The replacement value of the Pre-existing Property should reflect the cost of materials and commercial trade labour rates, to rebuild the Pre-existing Property to how it was prior to the loss. John needs to ensure that the value is correct as Pre-existing Property cover can be subject to the Average Clause. In the scenario above either Joe Blogs or John (again, depending who is contractually responsible) will need to evaluate how much it will be to rebuild the existing house.