

ACE PRIVATE RISK SERVICES®

MANAGING HOME RENOVATION RISKS FOR HIGH NET WORTH HOMEOWNERS

PREPARING FOR A BROAD ARRAY OF FINANCIAL
AND PERSONAL SAFETY EXPOSURES



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September 2014

Many families look forward to expanding or remodeling their home as a chance to improve their lifestyle and make a home truly theirs after purchasing it from someone else. But too often the renovation process becomes more arduous, expensive or risky than necessary – especially for owners considering major work to a custom-built home. While many homeowners consult with their financial advisor to evaluate the associated costs and financing options, far too few turn to their insurance agent to assess the risks. Consequently, they may unwittingly expose themselves to uninsured property loss, liability lawsuits, and family safety threats.

These risks range from the abandonment of projects partway through by contractors experiencing financial problems to kidnapping and extortion schemes perpetrated by workers with unknown criminal pasts. Other perils include the theft of building materials or valuable home contents during the construction phases, damage to the home caused by fire or weather, health issues deriving from all the dust and other airborne

particles caused by sanding, sawing and plastering, and the vulnerability of family members' personally identifiable information to a data breach.

Numerous examples also abound of contractors who failed to carry enough workers compensation and liability insurance, putting the homeowner on the hook for the cost of worker injuries and construction defects, among other dire exposures.

Even after a major renovation is completed, there is the risk of not having appropriate or enough insurance coverage to address improvements to the home and new contents. Indeed, the list of financial and personal threats is a long one, making proper counsel from an insurance agent critical at all stages of the project.

In this white paper, the three phases of a major home renovation project—*before, during and after construction*—are addressed from the standpoint of the respective risks and action steps to mitigate the exposures.

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MARSH

At Marsh Private Client Services (PCS), our mission is simple: to help successful individuals and families protect their property and their lifestyles by providing expert personal insurance consultation, solutions, and services. Marsh PCS has been a pioneer in the field of personal insurance advisory services since our beginnings in 1980. We realized then that the standard

approach followed by most insurance companies does not take into account the unique risks facing those with wealth, so we built our business by individually customizing personal insurance programs for each of our clients. Take advantage of this white paper to learn more about retirement planning that's right for you and your lifestyle.

PART ONE: ACTION STEPS BEFORE CONSTRUCTION

The biggest mistake a homeowner can make in undertaking a major renovation or home addition is to select an inferior general contractor. So many risks and liabilities emanate from the general contractor that this decision alone can prove the costliest error.

While most contractors and subcontractors are highly reputable organizations, particularly those that specialize in higher end residential projects, a report by the Joint Center for Housing Studies at Harvard University underlines the ease with which one can form these businesses. “Capital needs generally are modest and licensing and registration requirements for contractors are minimal in most communities,” the report stated. It noted that subcontractors involved in home renovation projects, in particular, are “highly susceptible to failure.”¹

Unreliable contractors will often close down a business that has earned a bad reputation and simply open another under a new name. If their license has been suspended, they may “borrow” someone else’s. So-called “traveler” contractors—the annual migration of unlicensed contractors who may be posing as experts in roofing, painting, dry wall and other remodeling tasks – pose a particular concern. Often, such individuals will appear perfectly professional and present what appears to be a great deal. However, they will typically use defective materials that require rebuilding, and then seek to change the terms of the arrangement.

The situation created when contractors go bankrupt or simply abandon a job can lead to more than aggravation and monetary loss. In one instance, parents with young children at home found themselves answering the door at night to a parade of angry subcontractors who had never been paid by the contractor.

Finding and Vetting Contractors

With so much riding on the choice of contractor, homeowners must use a variety of methods to find a qualified and reliable one. On large projects, many homeowners typically hire an architect before retaining a general contractor and will rely partly on the architect’s knowledge of contractors to build a list of candidates and guide the review process. References from friends or neighbors who have had similar work done can also help identify potential contractors. The family’s network of advisors – realtor, financial planner, accountant, and attorney – may know of contractors who have done quality work for other clients. Finally, the growing list of web-based services for finding local contractors may help.

Checking with the Better Business Bureau and State Licensing Agencies

With a list of potential contractors in hand, homeowners can begin the vetting process by contacting the Better Business Bureau (BBB). The BBB receives more than 1.1 million inquiries on average each year from homeowners seeking reports on a contractor’s reliability and trustworthiness.

State licensing agencies can provide additional information on contractors, but unfortunately only 27 states have state-licensing requirements for contractors. In these states, the regulations vary. For example, in California, contractors must have four years’ experience, prove their financial solvency and pass a written exam to become licensed; whereas in South Carolina, they need to have only two years of experience, pass an examination and submit financial data.²



Both the BBB and state licensing agencies have limitations, however, because their reports rely heavily on complaints. “Aside from verifying that the contractor has a valid license, all the state agency here in Sacramento can tell you is if a particular contractor has not received any complaints,” commented Peter Gray Scott, an architect and former president of Ratcliff Architects, a large Berkeley, Calif.-based architectural firm. “They can’t necessarily tell you if the contractor is a good choice for your particular project.”

Consulting with Banks and Trade Vendors

These limitations put the onus on homeowners and their financial advisors to take charge of the situation, asking contractors for financial references from trade vendors and banks. It is vital to determine if the contractor has a line of credit and/or substantial working capital to pay for equipment, supplies and labor. Contractors also should be queried if they have incurred any customer complaints or safety violations in the past. If they decline to respond, this is a red flag. If they reply that they have had no prior customer problems, they should document the assertion in writing.

Inspecting Past Jobs

Brian Given, director of the Temecula, California, office of construction consulting firm, J. S. Held, Inc., has advised that homeowners ask contractors to showcase their most recent projects. “Most will be more than willing to do this,” he said. “To head off problems down the road, I would also select a contractor that specializes in the specific type of home you have—Tudor, Mid-Century Modern, Contemporary, and so on.”

When practical, homeowners should visit the homes of previous customers and physically inspect the firm’s work. Or, they should at least contact these homeowners and ask if they had any complaints whatsoever. Did the firm complete the project on time and on budget, was the contractor receptive to their concerns and issues, did subcontractors keep the job site clean and organized, was all equipment and materials secured at the end of each day?

Unreliable contractors will often close down a business that has earned a bad reputation and simply open another under a new name.

"Unforced Errors" on the Court

A family hires a contractor to build a tennis court on the property. The contractor fails to secure the proper permits and a worker is severely injured while trying to pave the soil with heavy equipment. The contractor had no license and no experience building a similar structure.

The latter is particularly problematical. Thieves steal more than \$1 billion in construction equipment each year in the United States, according to a study by the National Insurance Crime Bureau.³ Not only does this add to project downtime, the contractor or subcontractors owning the equipment may sue the homeowner for the loss.

Asking the Subcontractors

A suggestion from Scott Hobbs, president and owner of Hobbs Inc., a New Canaan, Conn.-based custom contractor specializing in high-end residential home building: “Ask the contractor who the best subcontractors are in plumbing, HVAC and electric, then call these companies and ask them who the best contractors are. You’ll learn what each party thinks of the other.” It also makes sense for homeowners and their advisors to contact architects that have worked with the contractor to gauge their impressions, if they haven’t already retained an architect.

Requiring Effective Background Screens

Finally, before moving to the bidding stage, homeowners and their advisors should notify the contractors that they and their subcontractors and crew will be expected to have their backgrounds professionally screened before officially getting the job. Any hesitation should cause concern.

More than just the professional integrity of these individuals needs to be examined, since they will often be able to learn the daily routines of the family, become privy to alarm system codes, and perhaps learn of valuable items in the family’s possession. Criminal background checks must be performed on all workers, asserted Mike Thakur, Chief Operating Officer at The Guidry Group, an international security consultancy. “Never just accept a contractor’s word that the subcontractors’ workers have been screened for past criminal behavior,” he said. “Ask who did the screening, then read up on this business. There are many fly-by-night background checking firms that do a superficial job for a hundred dollars.”



Although the owner will likely have to bear the cost, Thakur advised that every single worker undergo professional screening. “You need to know the background of everyone that sets foot on your property,” he said. “You have a responsibility to your family and a legal obligation to your domestic employees to ensure their safety and wellbeing.”

This point cannot be overemphasized. Thakur reports that in the case of one especially large home renovation, they screened the backgrounds of the proposed staff and crew and found that 30 percent had issues, including some with arrests for violent crime, cocaine distribution, and use of false identification.

Considering this risk to family members and property, insurance carriers such as ACE that specialize in a high net worth clientele often provide access to professional background screening services on a complimentary or reduced-fee basis.

Making the Final Decision

After developing the short list of potential contractors, the homeowner has the option of moving forward with a competitive bidding process or choosing one contractor to work with on a cost-plus arrangement.

In competitively bid, fixed-price contracting arrangements, the architect designs the project to the homeowner’s aesthetic and practical objectives, and produces a set of plans and specifications called the contract documents. These documents are sent to the general contractors being considered and serve as the basis for developing the cost of construction, including the bids of subcontractors and suppliers.

While this process is customary, it increases the risk of selecting an inferior general contractor, according to Hobbs. “The problem is that this process almost always results in the contractor with the lowest bid getting the contract,” Hobbs explained. “People may claim that price is just one component in their decision, but most of the time the cost predominates—even for high net worth homeowners.”

Home renovations are complex endeavors. As the project commences, the contractor’s costs often escalate beyond its stated bid. “It is difficult if not impossible for architects to anticipate all of the construction issues and address them in the plans and specifications,” Hobbs said.

In a cost-plus arrangement, the homeowner selects a general contractor and architect at about the same time. All three parties—the homeowner, architect and general contractor—work together to develop the renovation plans and specifications. “It is always best to have the contractor there when the architect makes hundreds of aesthetic decisions,” Hobbs said. “The contractor can add up the costs of these decisions and compare the sum to the budget. More informed decisions thus are reached on quality versus cost well before the construction begins, vastly reducing the risk of a surprise.”

Hobbs warns against a common mistake—a homeowner acting as the general contractor. “A homeowner has much less control over subcontractors than a general contractor would have, as the latter promises repeat business,” Hobbs explained. “Thus, there is less incentive for them to complete the business on time and on budget.” In addition, the homeowner must learn all the technicalities of the permitting and construction process, as well as secure the proper insurance for the project – all daunting tasks for a one-time job.

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CHOOSING A HOME RENOVATION CONTRACTOR CHECKLIST

Homeowners and their advisors must adopt a rigorous process to select the general contractor because so many problems can arise with a poor choice: faulty workmanship, cost overruns, job abandonment, unpaid subcontractors, worker injuries, theft, home destruction and more.

The following checklist will help with finding and vetting potential candidates:

Finding Contractors

- ☐ Ask friends or neighbors who have had similar work done for recommendations on contractors to use.
- ☐ Ask advisors – realtor, financial planner, accountant, attorney, and insurance agent – about contractors who have done quality work for other clients.
- ☐ If an architect has been retained, ask for contractor recommendations.
- ☐ Consider using the growing list of web-based services that feature client reviews of local contractors.

Vetting Contractors

- ☐ Check with the Better Business Bureau and state licensing agencies to get basic information on the contractor, such as the length of time in business and complaint track record.
- ☐ Ask banks and trade vendors to verify the contractor's line of credit and/or working capital to pay for equipment, supplies and labor.
- ☐ Talk to past clients about their experiences with the contractor and, when practical, visit the home to inspect the work. Look for contractors who have handled jobs similar to the one being planned.
- ☐ Ask the contractor who the best subcontractors are, then call the subcontractors and ask them who the best contractors are.
- ☐ Consider the advantages and disadvantages of competitively bid, fixed price arrangements versus cost-plus arrangements. The latter can reveal potential problems sooner and improve cost-versus-quality decision making.
- ☐ Meet the actual employees who will be on your job and ask how long have they been with construction company.
- ☐ Have the backgrounds of the contractor, subcontractors, and their crews professionally screened before making any final decisions.
- ☐ Make sure the contract details the responsibilities of all parties and the scope of their work, in addition to the materials that will be used and their respective costs. Consider having someone familiar with construction oversee the budget in addition to the contractor or project superintendent.

Contractual Considerations

To help assure the renovation goes smoothly, a legal contract must account for every aspect of the project. Many contractors will provide the client a copy of the American Institute of Architects' proposed contract, which is more boilerplate than specific to the actual project. All parties involved must work together to tailor the contract to the unique aspects of the job.

"Problems between owners and contractors typically come up because of misunderstandings and miscommunication," Scott pointed out. "That's why a complete and full contract is so important." He cited the example of a contract that does not address the responsibility for job site safety, which can lead to a contentious bodily injury lawsuit. "You want to be sure the contract says in no uncertain terms that job site safety is solely the responsibility of the contractor," Scott said.

A comprehensive contract should spell out the responsibilities of all parties and the scope of their work, in addition to the materials that will be used and their respective costs. The terms of payment, sales tax, permit fees, warranties, start-and-end dates, change-order processes, final review and sign-off procedures and the removal of debris are other elements of a carefully constructed contractor agreement. Cost overruns should also be addressed, as the workload almost always changes.

It is very important to make sure that someone in addition to the contractor monitors ongoing expenses versus the budget. "The contractor must juggle three responsibilities: schedule, quality, and budget," said Hobbs. "Sometimes, the budget suffers in the mix. Therefore, the client needs to ensure that cost information is presented on a regular basis in an easily understood format and that this information is reviewed by someone familiar with construction."

The Perils of Being Your Own Contractor

One homeowner thought a small repair job was simple enough for him to supervise but failed to secure workers compensation coverage. The laborer he hired fell off a ladder and eventually died as a result. The homeowner was promptly sued.

When an architect is involved, reviewing the contractor's monthly payment request is typically included in the architect's Construction Administration responsibilities. To judge whether the work has progressed as much as the payment request claims, the architect visits the site; only labor and material that is actually incorporated in the structure should be paid for.

Finally and importantly, homeowners should be extremely wary of any inclusion of language that states they will hold the contractor harmless for damages that arise in connection with the project.

Securing and Confirming Proper Insurance

Considering the risky and unpredictable nature of a major home renovation, the family's insurance agent must be involved during the planning stages to review the breadth and quality of the contractor's and subcontractors' insurance policies, as well as the family's existing insurance policies.

"The overarching goal is for the homeowner to rest assured that any construction-related problem that occurs during the project is the contractor's problem—not theirs," said Scott. "If anything disappears or is damaged during the course of construction, or anyone is injured, it's up to the contractor and the firm's insurers to take care of these concerns."

With this goal in mind, the family's insurance agent can ascertain whether or not the limits of protection in the contractor's and subcontractors' policies are more than adequate to address potential aggregate losses. Coverage can often fall short for owners of custom-built homes simply because the value of the home outstrips the conventional amount of coverage that contractors carry. In one case, a subcontractor welding gutters inadvertently set the home on fire when a spark entered an open window. The loss amounted to \$10 million, but the welder had \$2 million in insurance.

The agent can also verify or request that wording in the contractor's policies effectively names the homeowner as an additional insured. In many cases, the policies will include standard language stating that all of the contractor's clients are considered additional insureds without naming each one, since the contractor may have many clients over the term of the policy.

When reviewing coverage amounts, attention should also be paid to aggregate limits of coverage per project. The owner does not want to be caught in a situation where an incident at one of the contractor's other jobs consumes the coverage left for his job.

Furthermore, the best insurance contracts from the homeowner's standpoint would include wording that the contractor's insurance will serve as the primary insurance and also waive the right to subrogate claims against the homeowner and the homeowner's insurance policy.



Workers Compensation

Contractors and subcontractors should have workers compensation insurance, which absorbs the cost of injuries or illnesses occurring to employees during the course of their work. But not all do. While some states require that all employers provide workers compensation coverage, many limit the requirement to companies with more than 10 or with more than 25 employees. For this reason, the agent should verify that workers compensation covers everyone involved with the job. “The way the chain of liability works, the contractor indemnifies the owner, and the subcontractors indemnify the contractor,” Hobbs explained. “This way, the people doing the work have some skin in the game for whatever might happen to their workers and are responsible for safety procedures.”

As another check, local authorities granting building permits normally require proof of the contractor’s workers compensation coverage, which is why the contractor should always be the entity to make the application.

Alycen Moss, a partner specializing in construction contract law in the Atlanta office of law firm Cozen O’Connor, noted that it is not uncommon for malicious employees of a contractor or subcontractor to allege injuries or illnesses simply because the client is wealthy. This threat reaffirms the importance of conducting comprehensive background checks.

Importantly, homeowners and umbrella liability policies typically exclude damages that would be compensable under mandatory or voluntary workers compensation coverage; therefore, if the family permits workers without this coverage onto the jobsite, they run the risk of being responsible for legal defense costs, medical bills, and other damages related to an injury.

Furthermore, certain states have precedents that negate the workers compensation policy as the sole remedy for damages suffered by workers, potentially making the homeowner responsible for worksite safety. This makes the contractual risk transfer a critical part of the work performance contract.

Commercial General Liability

Commercial general liability (CGL) insurance protects the firm against third party liability claims and property loss arising out of the firm’s negligence. By reviewing the certificates of insurance, the insurance agent can verify that the coverage amounts at least match the value of the home and contents. “The most important factor to consider is the amount of coverage (the financial limits of insurance) in the CGL policy,” Moss said.

Bodily injury risks presented by curious neighbors or delivery company personnel who venture onto the construction site are covered under the contractor’s CGL policy, as are the theft of or damage to valuable art, jewelry, and other pricey items.

Hobbs pointed out that many CGL policies fail to transfer the risk of flooding to a subterranean space. “You can have an amazing rec room or a wine cellar and if it is flooded during the renovation process, you might not be covered,” he said.

The solution in these cases is to address the possibility of these losses occurring at the contract stage. “While a contractor is not required by law to show the homeowner his CGL policy, if he refuses, that would obviously be a red flag,” Moss said.

Coverage can often fall short for owners of custom-built homes simply because the value of the home outstrips the conventional amount of coverage that contractors carry.

SMALL JOBS, BIG RISKS

Small jobs require vigilance, too. In one case, a family hired someone to polish the wood floors in their five story city home for a fee of less than \$10,000. Sloppy work splattered and damaged the lower portions of the exquisitely finished walls, and inappropriate polishing materials left the floors in poor condition. The cost of repairs totaled \$300,000. Because homeowners policies typically exclude coverage for faulty workmanship, the family had to pay out of their own pocket.

In another instance, a family hired a handyman to refinish their deck. At the end of the workday, the handyman decided to store the stain soaked rags under the deck. The rags spontaneously ignited and caused a fire that burned the house down. The handyman had no insurance and no assets worth pursuing.



Unpaid Subcontractors

Moss highlighted one particular risk to address: the contractor who walks off the job because of a dispute or declares bankruptcy without fully compensating the subcontractors for the work they have performed. In such cases, the subcontractors can place a lien on the home to demand payment. “The subcontractors will look to the homeowner for the remainder due them, which is a problem if the homeowner has already paid the contractor for this work,” Moss noted.

CGL policies will not step in to reimburse unpaid contractors, but protection against the risk can take a variety of other forms, according to Moss. As one alternative, she suggested requiring the contractor to secure a payment bond for the subcontractors before the project commences. Given from J.S. Held suggested another alternative: make the contractor set aside funds in an escrow account to pay the subcontractors. “In such cases, the subs will typically sign an agreement waiving their right to post a lien,” he said.

Billing in arrears can also provide a form of protection. “The contractor works through May, bills in June, and is paid at end of June so that the owner always has 30-60 days of work in place,” Hobbs said. Or, the family could withhold a certain amount until job completion. “Homeowners should discuss options openly with contractor and architect to determine what would protect their interests while not straining the contractor,” Hobbs added.

Poor or Faulty Workmanship

The consequences of poor or faulty workmanship represent one of the more difficult risks to address. “If a contractor puts on a roof that later leaks and causes significant water damage to the house, the homeowner typically will go to the contractor and try to recover under the CGL policy,” Moss said. “But, a CGL policy excludes coverage for faulty workmanship.”

Curious Behaviors

Always wanting to be on top of the local housing inventory, a curious realtor decides to survey a home under renovation at dusk, after the workers have left for the day. As she wanders up close in the semi-darkness to get a peek inside, she steps into an open window well and falls into the basement, suffering serious injuries. Because the property was not properly barricaded and ringed with appropriate warning signs, the contractor and homeowner have a weak case in court.



The resolution often requires litigation and varies by state. Some states will allow coverage in certain circumstances for both the poor workmanship and the ensuing loss. Some will allow coverage for the ensuing loss but not the faulty workmanship. Some will deny coverage for both. The resource would then be the owner's homeowners insurance, but that, too, does not cover losses related to faulty workmanship.”

Further complicating the issue, problems from faulty workmanship can take years to manifest. By then, the contractor may be long gone. For instance, poorly sealed siding can let in small amounts of moisture that foster the gradual growth of mold and rot. In one case, a decade passed before a family noticed spots on the ceiling and walls. After tearing away the drywall to investigate, the owner discovered that an entire side of the home was full of mold and dry rot.

For these reasons, homeowners and their advisors should consider requiring the contractor to post a performance bond that guarantees the work will be satisfactorily completed according to the contract terms. Securing the bond could increase the cost of the project by 2 to 5 percent, but the extra cost adds peace of mind, especially for large jobs. “For any job costing \$100,000 or more, I would strongly encourage the use of a performance bond,” Moss asserted.

When the Code Doesn't Cut It

After an especially wet and humid winter, a homeowner notices cracks in the walls and ceiling. The house was built to code 10 years ago, but the code has changed and it turns out the foundation was not deep enough. The contractor met the minimum code requirements for the town at the time, but did not adhere to generally accepted construction practices that called for a deeper foundation. Unfortunately, the owner had not required the contractor to purchase a performance bond that would have provided coverage for the faulty work.

Personal Insurance Considerations

While contractors and subcontractors should have all the necessary insurance in place to indemnify the homeowner against any property or liability risks associated with the renovation, the personal insurance program of the homeowner should also be reviewed.

Builders Risk

Most importantly, the homeowner, agent, and advisor must assess the need for a builders risk endorsement to the homeowners policy. Due the high risk of property loss and bodily injury associated with home renovations, insurance companies typically restrict coverage when the cost of the home renovation exceeds a certain percentage of the home's insured value or when the family will live elsewhere during construction for a certain period of time, such as 30 days.

For instance, coverage for the home and contents could be reduced or modified. The amount of coverage for the home structure might be capped at an amount below the value of the home listed in the policy. Deductible amounts might be increased, and coverage for theft might be excluded.

By notifying the insurance company and purchasing a builders risk endorsement, the homeowner allows the company to charge adequately for the increased risk as well as to help make sure proper safety procedures are followed by the builders.

One caveat: While builders risk insurance absorbs losses from fire, wind, theft and vandalism, it might not cover earthquake or flood risks, or wind-related losses in beach zones, unless the policy has been specifically endorsed to provide such coverage. Hence, the great wisdom in having an insurance agent involved before a project commences.

Home and Other Structures

Planning for the renovation should also include a general review of coverage needs beyond builders risk.

Home structure: The family should not wait until after the renovation to have the amount of coverage for the home structure increased. Many homes have burned to the ground at the very end of the renovation project due to the prevalence of flammable rags and solvents during painting. While the contractor's insurance should apply, having the proper amount of coverage for the upgraded home is still prudent.

Other structures: If the improvements include new walkways, driveways, fences, swimming pools or other structures separate from the main house, the appropriate insurance limits should also be adjusted.

Valuable Collections

The increased risk of theft and property damage during construction presents the need to take an inventory of personal property and make sure jewelry, art, fine wine and other precious items have the added protection of a valuables policy.

While the contractor's insurance policy should indemnify the family against a loss, the contractor's insurance company will want proper documentation regarding the value of the affected property. Many types of collections have appreciated greatly in value, leaving many underinsured. In one case, a family updated a 30 year-old appraisal and learned that the value of their art collection had increased from \$2 million to \$100 million.

Having the items properly documented and valued on the valuables policy will greatly aid in a swift and fair settlement. Moreover, the family will be more confident that they have their collections properly insured after project completion.

Umbrella Liability

Although the insurance held by the contractor and subcontractors should fully address all liability risk associated with the renovation project, the onset of the project should also serve as an occasion to make sure that the family has adequate umbrella liability insurance to supplement the coverage in their homeowners policy, which rarely exceeds \$500,000.



Many do not. In a survey commissioned by ACE of households with \$5 million or more in investable assets, 40 percent had less than \$5 million in umbrella liability coverage, including 21 percent with none. But lawsuit verdicts and settlements arising from serious bodily injury can exceed \$10 million. In a home renovation related injury, if the workers compensation won't cover the entire amount of damages, the plaintiff lawyer typically will allege contributory negligence on the homeowner's part and seek payment. Imagine a stone mason traversing a roof to reach a chimney needing repair work. He slips and falls two stories when a shingle breaks loose under his foot. The attorney could claim that the homeowner failed to properly maintain the roof. If the attempt succeeds and the family is underinsured, they could be forced to sacrifice their savings and investments, homes, and even future income.

The prudent solution is to have an umbrella liability policy in place with a coverage amount that matches the family's current net worth and future income stream. Financially successful families may have trouble securing such an amount unless they insure with a HNW-market carrier. Standard carriers rarely offer more than \$2 million in coverage, while a HNW-market carrier in many cases can offer limits up to \$100 million.

Safety Systems

By consulting with their insurance agent during the planning stages of the home renovation, families may also find they have struck on the perfect time to install new safety systems in their home. With the subcontractors already on site and the walls already opened, the incremental cost of installation may never again be so reasonable.

While most high value homes will already have burglar and fire systems installed, other devices worth considering are:

- Water and gas leak detection systems that automatically detect leaks and shut off the main supply
- Standby generators that run on natural gas or propane and automatically start when the utility power fails
- Temperature and humidity monitoring systems tied to a central alarm
- Battery power and backup capacity for sump pumps
- Lightning protection systems

Companies that specialize in serving financially successful families frequently offer premium discounts when such systems have been installed. For instance, in many states, the combined discount for multiple systems can exceed 30 percent of the base homeowner premium with ACE Private Risk Services. The companies may also have special agreements with preferred suppliers that will reduce the initial cost of installation, as well as company staff who can help arrange the initial appointment.

Dangerous Behaviors

Especially on minor projects involving one or two workers, homeowners may be tempted to supervise the work.

They should not. By putting the workers under their direction, they put themselves at risk. They inadvertently have opened up a line of responsibility for accidents that may occur. Homeowners should stick to setting goals for the project and signing off on work that has been completed satisfactorily.

Homeowners may also be tempted to help out by giving workers access to equipment – a ladder, a rope, an axe. By doing so, they expose themselves to lawsuits claiming faulty equipment. Contractors and workers should always supply everything they need to complete the job.

The homeowner may also want to take advantage of a service typically offered by HNW-market carriers—a thermographic inspection. Using a special camera sensitive to infrared light, the inspection can reveal cool and hot areas that could indicate moisture intrusion, poor insulation, and overheated wiring. As with the installation of safety systems, addressing these problems within the scope of the renovation could prove very cost-efficient.

Batten Down the Hatches

To guard against theft and property damage, the family should safely secure their personal information and property. They should move valuable items and computers and paper files with sensitive information to a room with a strong door that can be locked during working hours.

Families who will live elsewhere during construction should strongly consider moving private records and valuable items to an off-site location. Removing these items from the premises also reduces the possibility of physical damage—vibrations caused by construction can inadvertently push a valuable painting from its moorings or overturn a fragile sculpture. Dust, fumes and chemicals can similarly cause damage. Obviously, it is prudent to have professional craters and movers involved in these activities. It is also sensible to affix GPS chips to valuable art and other collectibles to help locate their whereabouts in the event they are stolen.

INSURANCE CHECKLIST FOR HOME RENOVATIONS

The family and wealth advisor should involve the insurance agent before the contract is signed to make sure the contractor's, subcontractors', and family's insurance policies will address all potential risks.

Contractor's and Subcontractors' Insurance Requirements

- ☐ Workers compensation coverage must be secured for all workers in case they are injured on the job.
- ☐ The comprehensive general liability (CGL) policies should have enough coverage to match the value of the home and its contents. The standard amount many contractors carry may not be enough to match the value of a custom-built home and its contents.
- ☐ The CGL policy, a payment bond, or an escrow account should protect the family in case the contractor goes bankrupt or abandons the job and does not pay the subcontractors.
- ☐ A performance bond should protect the family from faulty workmanship and any damage it causes after job completion, though securing the bond could add 2 to 5 percent to the cost of the project.

Family's Personal Insurance Requirements

- ☐ The need for a builders risk endorsement to the homeowner policy must be determined. The need usually depends on the size of the job and the length of time the family will live elsewhere during construction. Failing to secure the endorsement when necessary can trigger severe coverage restrictions.
- ☐ The amounts of coverage for the home and other structures on the property should be increased to account for the upgrades. Damage to homes frequently occurs in the final stage of construction.
- ☐ An inventory of all personal possessions in the home should be taken. Valuable items should have appraisals no more than three years old and be scheduled on a valuables policy.
- ☐ Umbrella liability coverage should be secured in an amount that matches the net worth and future income stream of the family in case an injured worker claims negligence by the homeowner.
- ☐ Installing a variety of safety systems should be considered as part of the renovation. Many systems earn insurance premium discounts, and installing them while construction is already in progress can prove very cost-efficient.
- ☐ After project completion, the coverage in homeowner and valuables policies should again be adjusted to reflect the improvements to the home and other parts of the property, as well as the improved furnishings and additional contents in the home.

Also, the family should have sensitive information and valuable items moved to a room with a strong door and lock. If the family will live elsewhere during the project, these items should be stored at a safe, off-site location.

PART TWO: ACTION STEPS DURING CONSTRUCTION

Assuring Worksite Safety

Assuring worksite safety for the family, crew, and home is the key consideration during a major home remodeling.

In situations where family members continue to live at the residence during construction or visit it on occasion, the risk of physical harm and kidnapping and extortion schemes is present. In addition to professionally screening backgrounds of all workers coming to the home, Thakur recommends that family members restrict conversations with workers to the general contractor and project superintendent, and ensure that work hours are at times when children are less likely to be on the premises, such as during school. “Keep on the lookout at all times for suspicious behavior, and stay within the parts of the house that are free of construction activity,” he added. Workers should clearly understand which rooms of the home are always off limits.

Flammable items demand special attention. “At the end of each workday, contractors and subcontractors need to store all flammable liquids like paints, varnishes and adhesives in UL-approved storage facilities located a safe distance away from the premises, and all rags in UL-approved fireproof cans that are removed from the jobsite at the end of each workday,” said architect Scott.

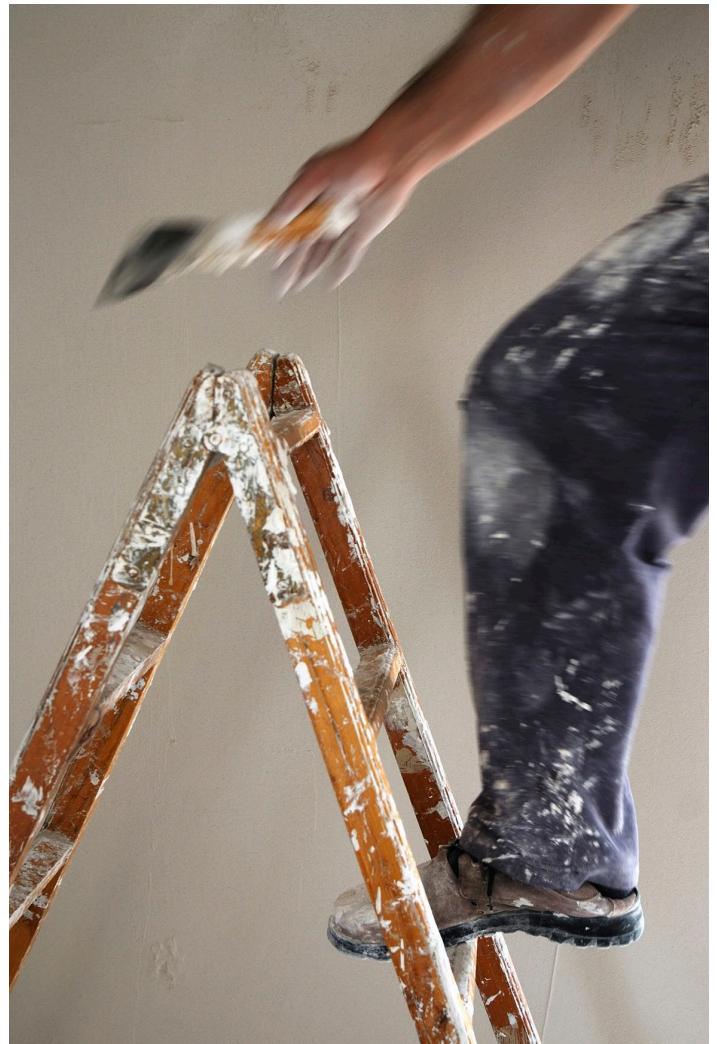
A “hot works” program should address soldering and welding operations. Such programs require workers to formally inspect the area prior to soldering or welding and protect nearby combustible materials from heat and sparks. A watchman must be appointed to ensure that a fire does not occur. The area should be re-inspected one hour after the work stops. No soldering and welding should be conducted during the last hour of the workday.

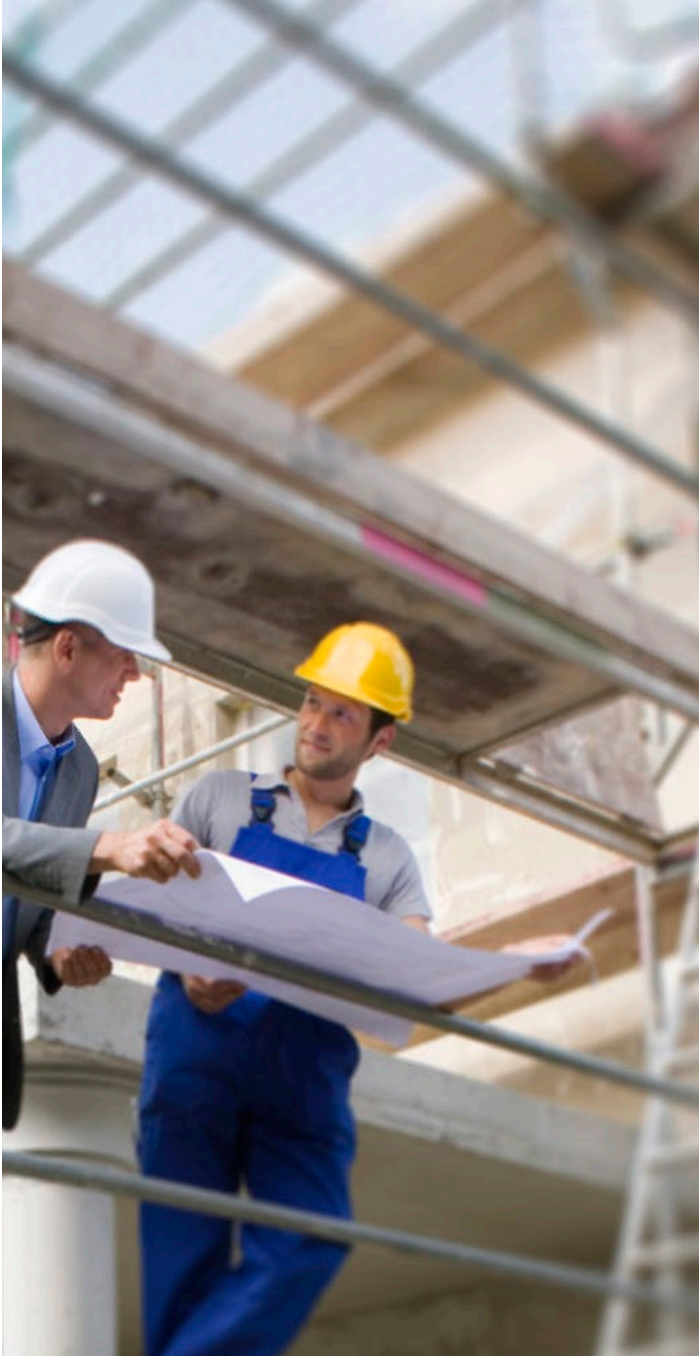
To reduce the risk of a fire spreading rapidly through the structure, ABC-rated fire extinguishers must be visible throughout the home, mounted on every floor level and clearly marked with a sign. Smoking also should be prohibited within 50 feet of the structure, with clear signage prominently displayed.

The homeowner and contractor should have a clear understanding of their roles in the use of alarm and sprinkler systems during the project expressed in the project contract. Under traditional homeowners insurance, the family may have a duty to protect people from injury, the property from damage, and the contents from theft. “It’s up to them to make sure the security and fire systems are in place and turned on, even if they’re not living in the house during the renovation,” said attorney Moss. “If the systems are turned off and items are stolen or a fire occurs and causes damage, it could result in a claims dispute.”

Keeping systems activated during the day, however, may be impractical because worker activities can trigger frequent false alarms – such as excessive dust from sanding setting off a smoke alarm. In this case, if the family is living elsewhere, they should make sure the contractor accepts responsibility for activating the appropriate alarm and safety systems at the end of each workday.

Keeping existing permanent alarm and sprinkler systems activated may also be impractical when the exterior walls are open and doors and windows have not yet been installed. Temporary measures should take their place. “We advise high net worth homeowners to wire up temporary security systems like a digital video recording system or a centrally monitored burglar and fire alarm system,” said security consultant Thakur. “If this is not feasible, hire a guard to watch the rest of the house as the construction takes place elsewhere.”





Signage should be prominently posted to warn visitors of construction in progress and direct package carriers and other visitors to safe entry posts. Motion-activated security lighting illuminating the perimeter of the worksite at night is another smart precaution.

Depending on the setting, size of the job, and local zoning ordinances, barricades or security fences around the perimeter of the house also should be considered to limit intrusion by strangers. The fencing should be at least six feet high and secured at the end of each day. Keys providing access to the security gate should be limited to the property owner, general contractor and project superintendent.

All construction areas should be sealed off from the rest of the house to limit noise, dust and other potential toxins from entering living spaces. Older homes, for instance, may have asbestos or lead-based risks. Scott recommended that contractors use a double curtain of polyethylene plastic sheeting to contain these elements, rather than the customary single sheet.

Protecting Against the Elements

Weather represents a persistent threat to the home, as the envelope of the house will frequently be open during the construction process. Furnishings and other contents that have not been moved into storage can be destroyed and the architectural integrity of the home compromised. Tarpaulins must be on hand at all times and the house envelope wrapped at the end of each workday. Drainage alternatives must be ready in the event that gutters, leaders or grades are temporarily sidelined. "The contractors that specialize in higher end homes will generally take care of these possibilities, but it never hurts to ask," Given said.

It is considered sensible to have the architect visit the construction site on an ad hoc basis. "Based on the architect's experience and knowledge of industry standards and building codes, he or she can observe whether the construction meets the intent of the design and respond to contractor questions," said Scott. Periodic site visits by other parties like an insurer's risk consultants are advisable to ensure proper controls are in place to keep the family safe and protect the home and personal possessions. Contractors should be informed in writing that these inspections are permitted.

Happy Camper. Unhappy Homeowner.

A beachfront home left vacant under construction seemed like just the spot for a good night's rest to a wandering soul on a cool, moonlit night. The abundant scraps of lumber made it easy to build a small fire. But the ocean breeze and exposed framing made the fire hard to control. Soon, the house was engulfed in flames, the wanderer long gone, and the family left to plan a much longer time away from home.

HOME RENOVATION WORKSITE SAFETY CHECKLIST

The following measures should be employed to assure safety for the family, crew, and home:

- ☐ Family members should restrict conversations with workers to the general contractor and project superintendent. All project related questions should be channeled through the general contractor's people.
- ☐ Work should be scheduled primarily when children are not at home.
- ☐ All ladders should be secured at the end of each workday.
- ☐ Debris should be removed from all work areas at the end of each work day and stored away from the structure.
- ☐ Flammable liquids like paints, varnishes and adhesives should be stored in a U.L.-approved flammable liquid storage cabinet located a safe distance from the structure. When not being used, the cabinet must be locked (especially on nights and weekends).
- ☐ All rags should be stored in U.L.-approved fireproof cans that are removed from the job site at the end of each work day.
- ☐ All extension cords should be disconnected at the end of each work day.
- ☐ For any soldering or welding, a "hot works" program should be in place that features:
 - ☐ Formal inspection of the area prior to work beginning
 - ☐ Protection of nearby combustible materials from heat and sparks
 - ☐ Fire watches adjacent to the work area
 - ☐ Regular re-inspections of the area for a minimum of 60 minutes after work is completed
 - ☐ No soldering or welding during the last hour of each workday
- ☐ Smoking should be prohibited within 50 feet of the structure. "No Smoking" signage should be prominently posted at areas of ingress/egress to the structure.
- ☐ 10 lb. ABC-rated fire extinguishers should be installed in visible locations throughout the structure. One extinguisher should be mounted on each floor level and every 1,000 square feet of space, and each mounting location should be clearly marked with a sign.
- ☐ If existing permanent fire alarms systems are impractical to keep activated, a temporary fire alarm system should be installed and activated on all levels of the structure that is monitored by a U.L.-approved central station facility. A detector should be placed every 750-1,000 feet, even in areas that are expected to be left unfinished.
- ☐ While the home is not fully enclosed or lockable at the end of the workday, a temporary digital video recording system should be installed with video cameras at key/elevated vantage points along the perimeter of the site and inside the main structure. In addition, visible signage should be posted that will alert anyone coming on to the property that the site is monitored.
- ☐ Security lighting should be set up to illuminate the perimeter of the site and structure as well as office trailers.
- ☐ All construction areas should be sealed off from the rest of the house with a double curtain of polyethylene plastic sheeting.
- ☐ Tarpaulins should be ever-present and the house envelope wrapped at the end of each workday. Drainage alternatives must be ready in case the primary methods are disabled.
- ☐ Depending on the size of the job, the setting, and local zoning ordinances, a security fence should be constructed to protect the site perimeter. The fencing should be at least 6 feet high and secured at the end of each day. Keys providing access should be limited to only the property owner, general contractor and project superintendent.
- ☐ A permanent fire detection system should be installed once construction is completed.

PART THREE: ACTION STEPS AFTER CONSTRUCTION

Once the project concludes, the homeowner should have all temporary fire, burglar, and perimeter lighting systems turned off, and ensure a single set of integrated systems encompassing the internal structure and external environs are in place and functional. Now is a good time to conduct another thermographic inspection of the house to discover evidence of post-construction defects.

Importantly, the homeowner or wealth manager should notify the insurance agent and company to have the builders risk coverage stopped and the amounts of coverage for the structure on the homeowner policy adjusted appropriately. Note: adjusting the coverage is not as simple as adding the cost of the project to the previous amount of coverage for the home. While mass-market insurance companies may offer little guidance in how much to increase coverage, HNW-market carriers will often send an expert to the newly improved home to produce a customized estimate of what it would now take to rebuild it.

This more accurate approach typically allows the HNW-market carrier to offer full replacement cost coverage in the homeowner policy. Available in all but a few states, full replacement cost coverage promises to pay the full amount to rebuild a home and other structures on the property after a covered loss no matter how much it exceeds the value listed in the policy. Mass-market carriers typically pay no more than the listed value on the policy or perhaps 25 percent above the listed value.

Finally, a larger or upgraded home typically has new and more valuable contents like furnishings and art in it. The family and advisor should work with the agent to reassess the adequacy of coverage limits for personal property and make sure to add new fine art or other collectibles to the valuables policy.

Conclusion

As this white paper clearly illustrates, the pride families take in improving their home must be coupled with an understanding of the risks that arise before, during, and after construction. For these reasons, high net worth homeowners and their financial advisors should collaborate with an expert insurance agent well before hiring the contractor. The best agents recognize the myriad of threats and proper insurance coverages needed during the different phases of the project, and can provide introductions to specialized insurers with vital ancillary services that reduce the prospect of financial loss and physical harm.



About the Quoted Experts

Brian Given, Director, J. S. Held, Incorporated

Brian Given consults on large loss and dispute resolution cases involving builders risk, infrastructure, luxury housing, and offices. He is a licensed California general contractor and has been responsible for construction projects with two of the nation's largest public developers.

Founded in 1974, J.S. Held, Inc. is a construction consulting and project management firm with more than 20 offices across the country. J.S. Held, Inc. personnel are uniquely qualified and experienced professionals who act as consultants, expert witnesses, project monitors, and arbitration panelists.

Contact: bgiven@jsheld.com

Website: www.jsheld.com

Scott Hobbs, President, Hobbs Incorporated

Scott Hobbs became president of the third generation custom building company Hobbs Inc. upon the retirement of his father in 1998. He is responsible for running all business operations with his brother, Ian Hobbs. As president, Mr. Hobbs has overseen more than 100 custom home builds and countless renovations and general home maintenance projects. He has more than 20 years of experience in the industry and earned an MBA from Columbia Business School's Executive Program.

Hobbs, Inc. is a specialized custom building firm based in the Greater New York area and the Hamptons. Founded in 1954, Hobbs, Inc. has grown to be one of the most prestigious custom builders in the country and has been recognized as Custom Home Magazine's Custom Builder of the Year. Hobbs, Inc. personnel are frequently acknowledged for the professionalism of their services and their leadership in construction safety.

Contact: shobbs@hobbsinc.com

Website: www.hobbsinc.com

Alycen Moss, Partner, Cozen O'Connor

Alycen Moss focuses her practice in civil litigation, with an extensive background in representing civil and commercial cases involving property and casualty insurance, products liability, and mass and complex torts. Ms. Moss is well-versed in handling complex cases involving high net worth individuals and was awarded as a Rising Star by Georgia Super Lawyers in 2010, 2011, and 2012. She is also a member of the Atlanta Bar Association, State Bar of Georgia, and Defense Research Institute.

Established in 1970, Cozen O'Connor delivers legal services on an integrated and global basis, with 575 attorneys in 22 cities and two continents. Cozen O'Connor lawyers counsel clients on their most sophisticated legal matters in all areas of corporate and regulatory law as well as litigation. The firm represents a broad array of leading global corporations and ambitious middle market companies in major industries.

Contact: amoss@cozen.com

Website: www.cozen.com

Peter Scott, Architect

Peter Scott has more than 50 years' experience in all phases of architectural services, from preliminary design, through construction drawings and specifications, construction administration, contract negotiation, consultant coordination, and management of design staff. He spent 25 years with THE RATCLIFF ARCHITECTS, Berkeley, ending as Partner, President, and Director of Design.

Mr. Scott has designed more than 100 custom homes and remodeled more than 200. He has also been retained by more than 40 law firms to serve as a forensic consultant on disputes involving architect services, standard of care, design and construction defects, and code and handicapped access. As a qualified expert witness, he has experience working for both defendants and plaintiffs.

Contact: petergrayscott@aol.com

1047 Alvarado Rd., Berkeley, CA 94705

Mike Thakur, Chief Operating Officer, The Guidry Group

Mike Thakur specializes in providing security consulting for private and corporate clients, both nationally and internationally. As chief operating officer, Mr. Thakur leads and develops the core service offerings and oversees general operations and client services for The Guidry Group. He is certified in Homeland Security and has a robust background in supporting legal, technical, and business operations for businesses and individuals.

The Guidry Group is an international security consulting firm, which provides innovative protection solutions for high-profile individuals, families, and businesses. Since 1985, The Guidry Group's staff of former U.S. Secret Service and Armed Forces members has operated in 125 countries around the world, assessing threats to their clients' well-being, confidential information, and business operations.

Contact: mthakur@guidry.com

Website: www.guidry.com

Endnotes

- 1 <http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w07-8.pdf>
- 2 <http://realestate.msn.com/article.aspx?cp-documentid=20741445>
- 3 <http://www.journalofcommerce.com/article/id23659>

ABOUT ACE PRIVATE RISK SERVICES

ACE Private Risk Services

150 Allen Road
Suite 101
Basking Ridge,
NJ 07920

www.aceprs.com

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Media Inquiries

Carla Ferrara,
Tel: 215-640-4744,
Email: carla.ferrara@acegroup.com

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