Refurbishments of existing structures: risk and insurance considerations

Sam Hiller of insurance broker, Gallagher, summarises the insurance challenges of refurbishment projects that structural engineers may find it helpful to be aware of.

Introduction

For sustainability and environmental reasons, government and industry are increasingly encouraging developers to refurbish and repurpose existing buildings rather than demolish and build anew.

In the UK, we saw this most recently in July with Housing and Communities Secretary Michael Gove's decision to stop Marks & Spencer's plans to demolish its flagship building on Oxford Street in London, and previously in March when the City of London Corporation issued new guidance making it increasingly difficult for developers to demolish buildings, with a strong preference for retaining them where possible.

Insurance considerations

It is not often appreciated that there are two distinct sectors of the insurance market: construction and property. Construction insurers' core appetite is insuring new-build projects, while property insurers' core appetite is insuring existing operational buildings that aren't being worked upon. Furthermore, construction insurers treat new contract works and existing retained structures separately.

Determining which sector of the insurance market (construction, property or a mixture/hybrid) will insure a project that involves works in or to an existing building can be complex and depends on numerous factors such as:

- the contract value of the new works
- the reinstatement value of the existing retained structure
- the age, condition and listed status of the existing building
- whether the new works are structural and how extensive they are
- whether the existing building will be occupied/operational during the works.

As a rough guide, property insurers will generally refuse to insure contract works where the contract value exceeds £5M (sometimes less) so a 'construction all risks' (CAR) policy will be required. Furthermore, construction insurers will usually only consider including existing buildings on a CAR policy alongside the works if the reinstatement value is similar to or less than the value of the new works and if the building is unoccupied during the works.

Where a development involves the refurbishment or extension of an existing retained structure, the standard JCT contract requires the employer to insure both the contract works for all risks and existing structures for specified perils in joint names with the contractor.

The standard JCT Design and Build Contract defines these perils as: 'fire, lightning, explosion, storm, flood, escape of water from any water tank, apparatus, or pipe, earthquake, aircraft and other aerial devices or articles dropped therefrom, riot and civil commotion'.

The use of this default contractual provision needs careful consideration depending on the insurance programme design. A negotiation will need to take place between the employer and contractor, ideally as early in the contracting process as possible, because agreement will need to be obtained from the insurers of the existing structure.

Naturally, the contractor will want to be insured (or given a waiver of subrogation) from the existing structure's insurers, as this best protects their interests. Conversely, the existing structure's insurers typically prefer to retain subrogation rights against the contractor and often refuse the request in the first instance.

Due to the potential dispute around the existing structures policy including contractors, careful consideration should be given to the third-party liability risk. Making sure this is correctly disclosed and negotiated with liability insurers is crucial.

Furthermore, in the event of a loss, it is the contract that will determine the route of the claim, not the agreed insurance position, so all parties' legal and insurance advisers should be involved to ensure all project contracts are drafted to reflect the agreed insurance position.

As well as the construction

> “DEVELOPERS SHOULD CARRY OUT EXTENSIVE INVESTIGATIONS BEFORE STRIP-OUT WORKS COMMENCE

and property insurances, early consideration should be given to latent defects insurance (LDI), which is typically driven by tenants and investors on large new-build schemes. Due to the necessary technical audit process which commences from the beginning of construction (usually piling commencement), obtaining LDI on refurbishments can be significantly challenging, depending on the type of risk. This is because LDI is primarily designed for new-builds.

The technical audit is deemed essential by LDI insurers as it allows them to provide input and advice during construction in a bid to minimise the risk of inherent defects arising; securing LDI cover at practical completion is dependent on a successful audit. Clearly, for already built structures, this is not possible, so LDI is generally only potentially possible on large, extensive refurbishments where a significant amount of the structure is being altered. However, it is highly risk dependent and early engagement with your insurance broker is recommended.

Challenges

The appetite and cover available for refurbishments has changed significantly since 2019, due to a number of substantial high-profile losses, e.g. Glasgow School of Art[1], Mandarin Oriental hotel[2] and Primark Belfast[3]. This sector has been at the leading edge of the hardening insurance market.

There is also nervousness as reinstatement following damage can be slower than with new builds. Understanding costs associated with retrofitting modern services to old infrastructure can also be difficult until a loss, leading to higher claims.

Delays can occur due to the discovery of asbestos, the need for specialised trades with longer lead times (e.g. stone masonry), and perhaps issues around re-securing planning permission. Listed structures are especially out of appetite for construction insurers, as demonstrated in the recent example of Manchester Town Hall[4], which is significantly delayed and over budget due to discoveries being made about the true condition of the existing structure.

Solutions

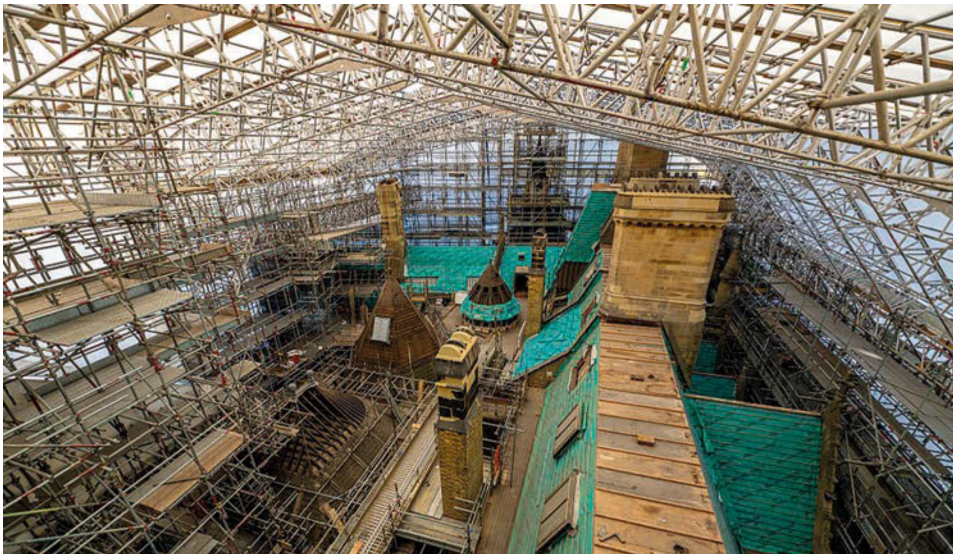
As refurbishment projects often fall outside of an underwriter's core appetite, especially on a one-off or bespoke basis, developers and employers of refurbishment projects should leverage their existing insurer relationships as much as possible.

This should include engaging their existing property insurers, and in turn their construction underwriter colleagues, to ensure there is as much synergy as possible across any construction, property or hybrid insurance placement.

This is especially important in a scenario where the existing structure itself has to remain covered in the property market and the new works need to be covered in the construction market.

Developers should also:

- consider the actual reinstatement value of just the retained structures that will form part of the new development, i.e. post strip-out and demolition
- carry out extensive investigations before strip-out works commence
- provide a recent condition survey of the existing structure, which will ideally demonstrate that the existing structures that will be retained are in a very good condition and can more than handle the new load and any anticipated movement
- further to any concerns highlighted in the condition survey, provide details of the risk mitigations that will be carried out to resolve or minimise the risks
- provide details on how the risk of damage to the existing retained structures arising from works will be mitigated, e.g. fire risk management strategy, hot works procedures, fire blankets, fire watch inspections.



↑ The project to refurbish Manchester Town Hall illustrates the risk of discoveries about a building's condition leading to increased costs and timeframes

Conclusion

While cautiously optimistic, we don't anticipate that the insurance market situation in the UK will improve in the short to medium term. However, developers that engage specialist insurance brokers early in their plans – as they would a design consultant, etc. – tend to put their best foot forward when managing risk, seeking the best possible coverage and securing the most competitive terms.

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