



CONSTRUCTION & ENGINEERING TOOLKIT

Insuring existing buildings in which and next to which construction work is to take place

JCT CONTRACTS IN REAL ESTATE DEVELOPMENT

Property developers, funders, contractors and consultants will be familiar with JCT building contracts. The agreements produced by the Joint Contracts Tribunal are the most commonly used contracts in the UK construction market.

Most real estate projects tend to be new builds with the developments constructed on empty sites but it is not uncommon for construction work to take place in, on and next to existing buildings. This is particularly the case in urban areas and this is likely to become more commonplace in the next few years as the minimum energy standards for letting buildings (required by the Energy Act 2011) take effect.

MINIMUM ENERGY STANDARDS FOR LETTING BUILDINGS

From April 2018, legislative changes will make it unlawful to let residential or commercial properties with an EPC rating of F or G (the lowest two grades of energy efficiency). This could have very significant implications for landlords and occupiers who wish to let, assign or sub-let space.

Accordingly, in the run up to 2018, property owners and occupiers should make sure they have a clear understanding of the energy efficiency of their property assets. Owners and occupiers will need to assess the costs and viability of undertaking retrofits or refurbishments and possibly bringing forward properties for marketing prior to 2018 or re-gearing leases.

CONSTRUCTION WORK ADJACENT TO EXISTING STRUCTURES

This toolkit considers building work commissioned by a client at an existing property where the construction works themselves take place adjacent to structures that already exist.

INSURING THE EXISTING STRUCTURE

Where construction work is carried out to (or next to) an existing structure and a JCT building contract is used, the general intention is that JCT insurance option C, set out in schedule 3 to each JCT contract ("**Option C**"), is meant to apply.

Under this option, the employer is required to take out and maintain insurance both in relation to the actual works (as they are being built) as well as the existing structure.

The policy is meant to cover the full cost of reinstatement, repair and/or replacement of loss or damage to the existing structure due to the occurrence of a "Specified Peril".

"Specified Perils" includes 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 insurance policy is to be in the joint names of the contractor and the employer. The insurers are to waive any rights of recourse they may have against the employer and the contractor as well as sub-contractors.

WHAT HAPPENS IF EMPLOYER IS A TENANT?

This is all relatively straightforward if the employer is the owner of the building and has taken out its own buildings insurance.

However, if the employer is a tenant in the building and the buildings insurance is maintained by the landlord, then the matter is not quite so simple.

Landlords are reluctant to include tenants' contractors as insureds under their buildings insurance policies and obtain waivers of subrogation rights against sub-contractors. Doing so would affect their premiums.

As a result, the tenant employer is not in a position to satisfy the requirements of Option C.

ALTERNATIVE SOLUTIONS TO OPTION C

Accordingly, tenant employers need to put in place alternative insurance arrangements.

These usually boil down to requiring the contractor to maintain third party/public liability insurance (with an appropriate level of cover) to respond to any damage caused to the building in which the works are to be carried out.

This approach entails either:

■ Amending Option C

Such that the employer is not obliged to maintain insurance of the existing buildings and their contents but is still required to insure the works themselves (with consequential amendments being made to other clauses, such as clause 6.2, which cross-refer to Option C); or

■ Using either JCT Insurance Options A or Option B (depending on whether it is the contractor or the employer who is to insure the works)

Here, reference is only made as to which party is to insure the works and no requirement to insure the existing structure is referred to. Any damage to the existing structure would be dealt with in the same way as damage caused to third party property (some amendments to the JCT contract will be required including removing references to "New Build" from Option A or B, as appropriate).

TAKE CARE AND BEWARE

Whilst the above approach is not an unusual one, it does not provide a perfect solution to the usual Option C insurance arrangements.

Key differences between the Option C approach and the above alternative arrangements:

- If the tenant employer chooses to go down the alternative arrangements route, it will be the tenant's main contractor who will have responsibility for (and be required to maintain) the public liability insurance.
- This means that, if the tenant's contractor fails to maintain that insurance properly, the tenant will have to look to the contractor itself to cover any shortfall in insurance recovery.
- There is a risk that the public liability insurance cover to be maintained by the tenant's main contractor may not be sufficient to cover reinstatement costs in the event of any substantial damage to or the entire destruction of the building.
- Under a JCT building contract, the contractor's public liability insurance is only required to react to damage to property caused by the negligence, breach of statutory duty, omission or default of the contractor or those for whom he is responsible. This means that the public liability insurance will not react to damage to the building caused by Specified

Perils (which are the risks normally covered by Option C) unless it can be established that their occurrence has been caused by the negligence, breach of statutory duty, omission or default of the contractor or those for whom it is responsible.

SEEK INSURANCE ADVICE AND ENGAGE WITH THE LANDLORD

When construction work is to take place in an existing building or adjacent to an existing structure, it becomes clear that careful consideration needs to be given to the interface between the building works to be carried out (the tenant's works/fit-out) and the existing property itself.

It is of paramount importance that the landlord is consulted as early as possible in the procurement process to ascertain its willingness or otherwise to include the contractor as an insured in the buildings insurance policy (and obtain the requisite waiver of subrogation rights) and advice is sought from appropriately qualified insurance brokers.

This toolkit forms part of our series of Construction guides. For more information, go to www.dlapiper.com.

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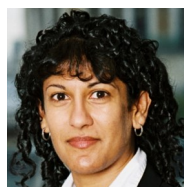
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