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FEBRUARY 2019

HOW TO BUILD COST EFFECTIVE SENIOR LIVING FACILITIES

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Growing Need for Senior Living Facilities

The senior living industry continues to build out and refurbish its footprint throughout the United States, regardless of less than optimal occupancy rates of 88 percent for independent and assisted living facilities in Q4 2018[1]. The need for these facilities will continue to grow in the coming years as increasing numbers of the "silver wave" transitions out of their homes and into independent and assisted living facilities.

The end of 2018 marked the first time since 2015 that consumers' increased demand for seniors housing kept pace with the increase in the inventory of new units, according to the National Investment Center. The unit absorption rate is increasing, meaning operators have an opportunity to expand operations, but they must be selective and opportunistic when purchasing existing facilities or planning for new development. We seek to outline how these operators can cost effectively mitigate the construction risks of new senior living facilities.

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Understanding Project Risks

As senior living operators continue to assess strategic construction developments, it is important for them to be well versed in the project risks. These operators should understand builder's risk policies and owner controlled insurance programs (OCIP) well, from both a cost and liability perspective. Senior living facilities are typically constructed with wood-frame type products, which offer cost savings, provide adaptability, and react fairly well in seismic situations.

In spite of these benefits, wood-frame construction is not viewed as favorably by insurance underwriting companies as other superior construction classes, which are less susceptible to damage from fire, water, wind, and hail. From a cost perspective, these projects can be more expensive to insure due to large fire losses through the U.S. from wood-frame habitation projects.

Builder's risk (construction insurance) policies are important for developers that have their own internal general contractors (GCs) through protecting insurable interest in materials, machinery, fixtures, or equipment throughout the course of construction. The duration of a project and ever-changing conditions of a construction

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project leave it vulnerable to impact by weather, arson, theft, and more. This policy provides broad property protection to the owner, general contractor, and subcontractors of all tiers.

In addition to providing indemnity for the hard costs of the construction, the builder's risk policy can also provide coverage for soft costs, additional interest, taxes, and insurance costs that are accrued as the result of a loss, as well as business income (loss of rents) coverage. Greater emphasis is being placed on project site security, with "fully fenced" and "well lit" being the minimum standard accepted by underwriting companies for projects of any size.

Utilizing Wraps

OCIPs, commonly referred to as "wraps," provide the developer of projects protection during the construction or renovation of a property to cover almost all liability and loss arising from the project. Typically, the coverages provided under an OCIP include commercial general liability, offsite work, auto, workers' compensation, and umbrella policies.

OCIPs offer the developer several benefits, including selecting type, scope, and limits of coverage, as well as lowering insurance costs and reduced litigation. Similar to the builder's risk policy, the OCIP is intended to provide coverage for the owner/developer, general contractor, and subcontractors under one program, nullifying coverage wording discrepancies and the potential of insufficient limits.

Utilization of the OCIP allows the general and subcontractors to provide their quotations net of their insurance costs, as their practice policies will not be exposed to potential losses from the project. This also alleviates the general contractor from regularly collecting certificates of insurance from all subcontractors throughout the duration of the project term. This is a cost saving passed directly onto the owner/operator, as general contractors at times pad their insurance costs so that the owners are ultimately paying (sometimes upwards of 35 percent above the actual cost).

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Additionally, when the owner is the party procuring the OCIP or builder's risk policy, they have more control of policy language and the response to a given claim, ultimately putting the owner/operator at a cost and risk mitigation advantage. If you are a senior living operator utilizing an independent general contractor, it is important that you understand the actual costs associated with these placements and how the policy language might favor the owner/developer or contractor.

As the need for new senior living facilities increases over the next several years, it will be important that the owners and operators of these projects understand the benefits of controlling both the costs and placements associated with OCIPs and builders' risk policies. If utilizing an independent contractor, having an insurance broker complete a policy review is important. By partnering with a commercial insurance broker that understands this market from a policy language and pricing standpoint, senior living developers of these projects can ensure they are most cost effectively mitigating the risks associated with these developments.

References and Resources

1. https://www.nic.org/news-press/year/2019/