Is your construction project adequately insured against inflation?

As a general contractor or project owner, it is crucial to ensure that your construction project is adequately insured, particularly in a high inflation environment. Canadian inflation is at levels not seen in 40 years; therefore it is important to assess its impact on your construction project.

Ensuring adequate limits

If your construction project is longer than 18 months, you should ensure that your limits of insurance have kept pace with inflation. In the event of a total loss near the end of the project, an insufficient limit could result in your organization's bankruptcy. The biggest risk that inflation poses to your construction project is having a limit of insurance that is too low. The longer the construction period for your project, the greater the potential impact inflation can have on your required insurance limits.

Statistics Canada tracks average construction costs across Canada with a measure called the "Building Construction Price Index".[1] This index tracks construction prices in 11 metropolitan areas in Canada on a quarterly basis. The index is used specifically for residential and non-residential building projects. If your project is for civil construction (such as a bridge or roadwork), the index can be used as a guide; however, more detailed analysis of inflation may be required for these projects.

Your Builders Risk policy

Most Builders Risk policies have an automatic limit increase clause in the 5% to 10% range, which does provide some protection in the event of higher inflation. Many property policies have a coinsurance clause that can penalize the insured in the event of a loss if the property does not have an adequate limit of insurance. Please note that Victor's Builders Risk policy does not have a coinsurance clause; you should consult with your broker to determine if there is a coinsurance clause contained in your policy.

What happens if the construction project is not completed on time?

It is common for construction projects to take longer than originally anticipated. This usually requires a term extension to your Builders Risk policy. Typically, insurers apply a proportional premium for term extensions. For example, if a $20 million project for 25 months has a premium of $100,000, every additional month would cost at least $4,000. In a high inflation environment, insurers know that the $20 million limit is likely not adequate and will surcharge the term extension premium due to inflation.

Most losses on construction projects are partial losses, so why do I need to worry about inflation?

Total losses on construction projects are rare and insurance rates are set accordingly. If the $20 million project mentioned above would actually cost $25 million to rebuild when adjusted for inflation, then insurers would not be obtaining premium relative to the actual exposure. It is for this reason that insurers will surcharge during the term extension underwriting process, to account for this "underinsurance" scenario.

What is causing this higher level of inflation?

There are a number of factors that are currently driving inflation. One factor is supply chain issues following the COVID-19 pandemic. Strong consumer demand, worker shortages and even the Russian invasion of Ukraine are additional factors that have impacted inflation. As a result, labour and material costs have increased significantly in the last 12 to 18 months.

Be sure to speak with your broker to ensure that you have appropriate insurance limits in place for your construction project. As highlighted in this article, there are a number of factors that need to be considered.

Visit us at victorinsurance.ca to learn more.

[1] Statistics Canada, https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810013501