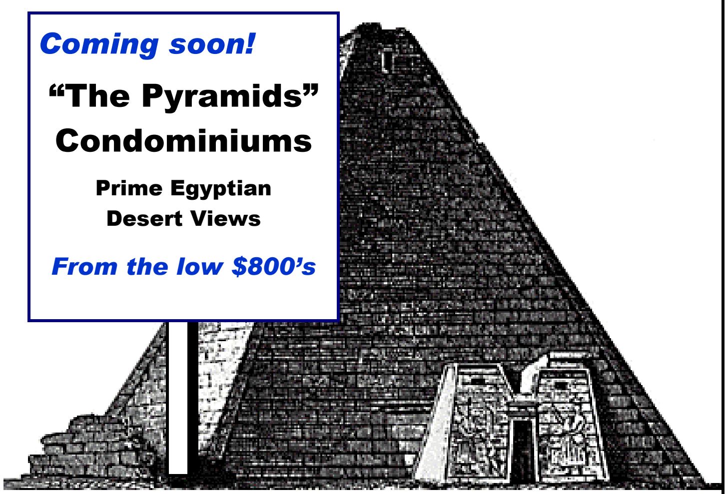
Construction Industry Update

MSP Construction Update 01/2005: "Condominium Conversions—What Do Underwriters Look for?" January 2005

Condominium Conversions: What Do Underwriters Look For?

By Jeffrey W. Cavignac, CPCU, RPLU, CWCA

Cavignac & Associates recently hosted a round table discussion that dealt with risk management issues facing condominium conversions. The meeting included representatives from the construction, legal, insurance underwriting and insurance brokerage industries.



In general, underwriters perceive condominium conversions to be more risky than "the ground up" construction projects. Much of this has to do with the age of the structures being converted as well as the buyers' perceptions.

Among many topics covered in the round table discussion was the key issue of "protocols" – things that developers should do not only to lower their exposures to loss, but also to improve their underwriting profiles to make them more attractive to the insurance industry.

Here are some of the factors we agreed developers/design professionals/contractors should consider when working on these types of projects:

1. **Project Selection** – When it comes to conversions, factors such as the age, location, condi-

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tion and the purpose of the original structure are critical.

2. **Contracts** – The contract that a converter has with the seller is crucial. Is the converter required to indemnify the seller? If so, what's the scope of the indemnity?

3. **Scope of Review and Destructive Testing** – Scope of review and destructive testing are tools to determine what needs to be fixed. What do you know about the site and the original structure? Is your philosophy *"If it works, don't fix it,"* or *"Look for anything that might fail in the future and replace it before it fails for a homeowner?"*

4. **Experience of Design/Construction Team** – Has the team (developer/design professional/ contractor) done this type of work before? Has the developer worked with the team before? What is the team's track record?

5. **Solid Third-Party Inspection Services** ensure good construction and a good connection between what is wrong with the existing building and what is done to fix it. Favorable inspection reports from reputable inspection companies will significantly enhance your chances with an underwriter.

6. **Appropriate Disclosures** should be made in all sales brochures and Purchase/Sale Agreements that reference the type of project, what has and has not been upgraded, and the availability of inspection and engineering reports. In addition, make sure that the disclosures are open and obvious rather than buried in obscure portions of public reports and documents.

7. **Incorporate SB 800 (Right to Repair) Standards (as appropriate)** – Incorporate SB 800 into your contracts. SB 800 is a specific process to resolve construction defect suits prior to litigation, but it does not apply to conversion projects. It can be added contractually.

8. **Comprehensive Maintenance Manuals and Annual Re-Inspections** – Maintenance Manuals should be complete and comprehensive, and every homeowner should get one. Annual inspections paid for by the Homeowners Association should be built into the Homeowners Association Agreement. Such inspections enable the developer/design professional/contractor, if appropriate, to evaluate the site on a regular basis to make certain that required maintenance is being performed.

9. **Offer Best-in-Class Customer Service** – Provide "best-in-class" customer service throughout the ten-year Statute of Limitations period. It is usually far less expensive to fix a problem when it is first recognized than to wait until later, when the problem may well have escalated in scope and severity.

Conclusion

Southern California is currently in the grip of a "conversion craze." Just about any structure (it doesn't have to be residential) in a residentially zoned area is a candidate.

Underwriters are evaluating these risks very carefully. A solid, documented set of risk management protocols should substantially reduce your exposure to loss and decrease your insurance costs.

Disclaimer: *This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.*

Workers Compensation Audits

In California, the USRP Section V, Sub-Section 1 – Payroll-Remuneration, states:

> *"Except as provided herein, remuneration includes gross wages, salaries, commissions, bonuses, vacation, holiday and sick pay, overtime payments, the market value of gifts, and all substitutes for money earned during the policy period, etc."*

Did your last workers compensation audit include all of these?

Contractor Owners:

What Is Your Return on Your Investment?

By Michael R. Strahan, CCFP

When individuals invest in the stock market or any other income-producing venture, it's prudent to monitor the investment against a return expectation. If an investment is under-performing, time is well spent analyzing why the investment is not meeting the return expectation. The investor can then make an informed decision to "stay the course" or take corrective action.

The same can be said for an over-performing investment. Successful investors want to know why the investment is doing so well in order to replicate that success.

As an owner of your construction company (or any other business venture for that matter), you are an "investor." Do you set aside time every year to plan and set a targeted return on investment as a benchmark for regular comparison and analysis? Considering the extreme risks taken in the construction business and the significant dollars invested, why wouldn't you?

Too many contractors seem to focus on securing more work as the means to grow their bottom line. In reality, the correlation between "more work" and a higher "return on investment" (ROI) is questionable. If you don't have systems, procedures, and monitoring in place to manage growth, all you may be doing is adding more risk with little chance of return.

The best way to do your annual planning is to work backward. Start with your targeted ROI, and then compute your general and administrative expenses (GIA) along with your indirect costs and the gross profit objectives you hope to achieve in order to calculate the amount of revenue you'll need to reach your goals.

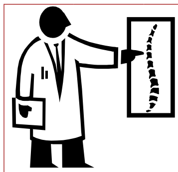
As you go through the annual planning process, consider the following:

- **Return on Investment (ROI) –** Establish your ROI at a level that makes your risk acceptable. Be sure to take into consideration some of the unique aspects of running a private business.
- **G&A/Indirect Costs –** This is probably the biggest drain on profits and also the easiest one to get away from the shareholders. What are your costs? Do you review them to make sure you are operating efficiently? Do you track them relative to your budget – or do you budget this at all?
- **Gross Profit –** The gross profit target you set should cover any indirect costs while still achieving your required ROI. Is the figure realistic based on historical profits?
- **Revenue –** As you enter the year, consider your backlog, then figure out how much additional work you'll need in order to achieve the gross profit you want and, ultimately, your ROI. Is this a realistic figure based on cash flow requirements, bonding capacity, management abilities, etc?

  If you have the capacity, you may decide to take on more work than necessary, but don't drop your margin below what you need to meet your ROI.

Once you have a handle on the above information, you should establish, at a minimum, monthly income statement forecasts and review them at least quarterly. Ideally, you should be able to produce monthly balance sheets, income statements and cash flow forecasts based on your annual plan.

Without forecasting, how will you be able to monitor your investment and take any corrective action? Considering the level of risk that a contractor takes, you need to monitor your investment to make educated business decisions.



Risk Control Corner

By Stuart Nakutin, AIC, WCCA, WCCP, CDMC

Want to Reduce Your Workers Compensation Claims?

Institute a Successful Safety Incentive Program (SSIP)

By Stuart Nakutin, AIC, WCCA, WCCP, CDMC, Director of Loss Control and Claims Department

You can reduce claims by instituting an Successful Safety Incentive Program (SSIP). This involves a cultural change in the way your workforce thinks about safety by instituting positive reward programs. Instead of penalizing employees who do not perform well, reward employees for non-optional good behavior.

Good Behavior Rewards Program (GBRP)

By making all employees eligible to win cash and prizes, all employees become involved in the safety process, and they will begin to change the way they think about safety and how to safely perform their work.

Here are the keys to success:

1. Mottos to Motivate

- Work safe today – you have a family
- Safety is doing the right thing – even when nobody is looking

Make the message *"safety because you care about your employees"* – no games, just safe behavior.

2. Begin an Immediate Safety Recognition Program (ISRP)

Look for safe work activities every day, all the time and give small rewards on the spot – Provide monthly awards. Keep the focus on safety by meeting and discussing accidents, near-misses, and safety every month. Celebrate injury-free months with as many employees attending over as many shifts as possible, and deliver with lots of enthusiasm.

Make the rewards large enough to influence behavior – For employees that are inclined to act carelessly and violate safety procedures, a pizza party or $50 is not going to change their behavior. You must offer at least one award that is desirable and large enough to encourage behavior change.

While you can't afford to have every employee win every month, you can have every employee who acts safely qualify to win every month. Then use a drawing to provide the award to one of them. Workers compensation costs are so high that they justify a meaningful award.

Encourage Positive Peer Pressure – Getting your employees to encourage each other to do the right thing and discourage unsafe or dishonest behavior is one of the cardinal rules for safe companies. If the rewards are meaningful, and there are positive benefits for teams and departments to be safe, you can create an atmosphere of teamwork and an important second level of peer pressure. Those who want to do the right thing are given a reason to step up and exert influence on those who are not as careful or dedicated.

Manage the Program – Stay involved and make changes to your program after both bad and good months. Stay visible, stay involved, and keep the program fresh and interesting. Add surprises, such as having the president attend, and spontaneously add a couple of $100 awards to names drawn from a hat.

If you invest the time, effort, and money, the payoff can be ten-fold. A safer company tends to be a happier company, with better morale and productivity.

If you have any questions, or would like more information on how to implement your Successful Safety Incentive Program (SSIP), please contact your **Cavignac & Associates** *agent.*

Get Your Cholesterol Checked

Courtesy of Cavignac & Associates Employee Benefits Department

Getting your cholesterol checked regularly is important to ward off heart disease. Start having your cholesterol checked every five years, beginning at age twenty. If you find you have an elevated cholesterol level, you may have to have it checked more often.

Children over the age of two should also be checked regularly if there is a family history of high cholesterol or heart disease earlier than age fifty-five.