

Builders Risk Endorsements Explained:

Business Income and Extra Expense

Commercial clients who purchase builders risk insurance are generally buying coverage that will, first and foremost, protect their investment should a loss occur to the structure and materials during construction. Beyond standard coverage, clients also have the option of purchasing additional protection for items such as business income/loss of rents and extra expenses.

This guide is intended to provide insurance agents and brokers with a deeper understanding of what business income/loss of rents and extra expense coverage includes, and how the period of delay is determined in the event a client experiences a loss.

Let's consider the following scenario to determine how business income/loss or rents and extra expense endorsements can better protect commercial business owners undergoing construction.

Your builders risk client, John, is opening his third retail store, and he purchased builders risk insurance with business income and extra expense coverage.

The original construction completion date when John started the project was November 1. However, construction has been running ahead of schedule, and the expected completion date to open the store is now October 1. Unfortunately, on September 1, lightning struck the 85 percent completed project, causing extensive damage to the structure.

It is estimated that it will now take two months to get the project back to 85 percent complete. The policy includes a 30-day deductible for business income, and a monthly indemnification limit of \$17,500/month.

To what extent is John covered for his losses? Let's take a closer look at business income and extra expense coverage to find out.

What does this endorsement cover?

Business income/loss of rents coverage offers insurance protection for lost income or rental income to the business owner (insured), resulting from a delay caused by a covered loss under the builders risk insurance policy when a previous contract for rental was established prior to the loss.

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Extra expense coverage offers reimbursement to cover actual extra expenses needed to avoid suspending, or to minimize the need to suspend, business operations. Extra expense coverage will also pay for costs associated with repairing or rebuilding to reduce further loss, even if such mitigation efforts are temporary.

Who should add this coverage?

This policy endorsement is only available when the builders risk insured is the owner of the structure; coverage is not available to non-owner contractors. The owner must either have an insurable interest in lost income for their business, or a loss of rental income for commercial properties.

When issuing builders risk coverage, one of an agent's roles is determining not only when coverage may be needed, but also which type of additional coverage is applicable.

How are coverage limits established?

Once the appropriate type of coverage for their client's policy is identified, an agent then must work with the client and underwriter to establish the coverage limits for the endorsement.

For business income, coverage limits are based on the actual net income of the business before the loss (the likely net income had a loss not occurred) and operating expenses including payroll and other financial records. Loss of rents coverage limits would provide reimbursement for the expected amount the property owner would have received in rental income from tenants prior to a loss impacting operation.

The amount of extra expense coverage is based on those expenses a business owner takes to begin operations at an alternate location, or to mitigate damage at the site of the loss. In our example, if John's roof were destroyed leaving the structure open to the elements, the extra expense coverage may pay for a tarp to protect the roof in order to limit additional damage.

In order to be eligible to add business income/loss of rents and extra expense coverage, most owners are generally required to have a track record of experience in the same or a related business field. For new business ventures, it may be possible to obtain this type of coverage based on pro forma financial statements and other documentation provided to a bank for a loan.

Coverage for this endorsement is capped by a monthly limit, which is established at the time the policy is issued.

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When is coverage triggered?

One of the biggest sources of confusion for agents and the insured is understanding when coverage for business income/loss of rents and extra expense is triggered. Coverage is only available when the business delay or extra expenses stems from another covered cause of loss to the structure. For example, if a flood damaged a construction site but the builders risk policy did not include coverage for flood damage, there would be no coverage consideration offered under the business income/loss of rents and extra expense endorsement. If the site was damaged by wind, and the policy included coverage for wind damage, and the business income/loss of rents endorsement was in place, then this endorsement would be triggered if there were an actual delay.

How is a delay determined?

Understanding how the period of delay is determined is critically important in the event a loss is realized. In general terms, the period of delay is the time period between the *expected* completion date and the *actual* completion date. Insurance coverage under this endorsement would be effective once the delay exceeds the deductible date specified in the policy. The deductible is determined in number of days not by a monetary value. The common timeframe for the day deductible option is anywhere from three to 30 days and, with underwriting approval, may be selected by the client during the application process.

Generally speaking, the more complete a project was at the time of loss, the longer it will take to get it back to the same phase again. However, in some cases when projects are ahead of schedule and no delay is anticipated, it is possible that a covered loss that causes a delay might not go past the policy's deductible period. In these situations, coverage for this endorsement would not be triggered.

Lost business income/loss of rents that exceeds the client's policy deductible period will be paid for the period of time necessary to repair, rebuild or replace lost or damaged covered property, subject to the policy's stated monthly limit of indemnity. Coverage for this endorsement should never extend longer than the term of the policy.

Let's look back at our example of John's losses due to the lightning strike to determine how, and to what extent, his losses might be covered.

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A two-month delay from the expected completion date (October 1) would be December 1. However, the delay does not begin until after the expected completion date on the policy regardless if construction is running ahead of schedule. The two-month delay John sustained is actually only 30 days after the expected completion date on the policy (November 1). Because the policy has a 30-day deductible, the delay did not exceed the deductible and no payment can be issued.

If the time period to bring the project back to 85 percent complete was expected to be three months rather than two, then the new expected completion date would be January of the following year, which is two months after the original completion date of November 1. After the 30-day deductible period, the policy would pay \$17,500 for one month of lost income.

If John is able to rent retail space to begin operations while construction is completed, this policy endorsement would cover the expenses associated with renting the alternate location, after the policy deductible period has tolled.

Conclusion

Builders risk insurance with business income/loss of rents and extra expense coverage can provide additional funds to cover these types of unexpected losses so your clients can get back to business with as little interruption as possible.

Builders risk insurance can be confusing to clients, so agents need to have a firm understanding of various policy endorsements and optional coverages. To learn more about available coverage endorsements, download our free eBook, [Reducing Risk: 5 Builders Risk Coverages Worth Considering](#).

To learn more about the Builders Risk Plan insured by Zurich, contact our dedicated team of more than 50 specialists at (800) 800 - 3907, or visit usassure.com.

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