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FROM THE EDITOR

Insurance claims for income-producing properties under construction, such as multi-family housing, are typically covered under a builder's risk policy. These claims are challenging. The coverage is significantly different than under commercial property policies.

Identifying lost income at a property that was not yet producing income further complicates the valuation. The lost income does not start on the date of loss. Instead, it's incurred during and after the delay in completion. It can be a challenge to identify all the critical factors that must be considered in this type of claim.

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Measuring Completion Delay Losses in a Builder's Risk Policy

Stabilized Versus Ramp-Up Occupancy Methods

By Harvey M. Goodman, SPPA and Zachary Weeden, CPA/CFF

In the insurance world, builder's risk policies are increasingly more popular as construction activity increases around the globe. These policies are constantly evolving with more coverages being added. But the goal stays the same – a settlement that properly pays the insured for revenue lost when finishing a project is delayed due to a covered property loss event.

The main coverages typically address soft costs, lost income, delay in start-up and extra expense. In all cases, one of the most important factors in getting a full recovery on a claim is properly determining the **full time period** a project's completion was delayed. This is key to measuring the economic damages accurately.

This article offers valuable insight into properly measuring these losses. It emphasizes how to treat revenue that would have been earned during both the planned "ramp-up" period and the actual (delayed) "ramp-up" period.

Knowing how to apply the terms of a builder's risk policy to the claim requires expertise in policy interpretation, construction and forensic accounting. This is especially true for calculating the lost revenue during the two ramp-up periods. A public adjuster experienced in builder's risk claims adds substantial value to the process. Their ability to properly forecast and measure lost income is crucial to a full recovery.

We trust you will find this article both insightful and useful. Enjoy!

Ethan A. Gross, JD
Editor

Different theories and methodologies can be used to determine the length of the delay. It's not uncommon for the insurer to take a different approach than the policyholder. Regardless of the method used, it is important to recognize that the economic impact often extends beyond the time it takes just to replace the brick and mortar. The policyholder is in the best position to know the actual financial impact of the delay. So, the carrier must rely on the policyholder's information - not only what's in construction schedules or charts. Therefore, the insurer must consider the possibility that the loss extends past the time to replace the brick and mortar.

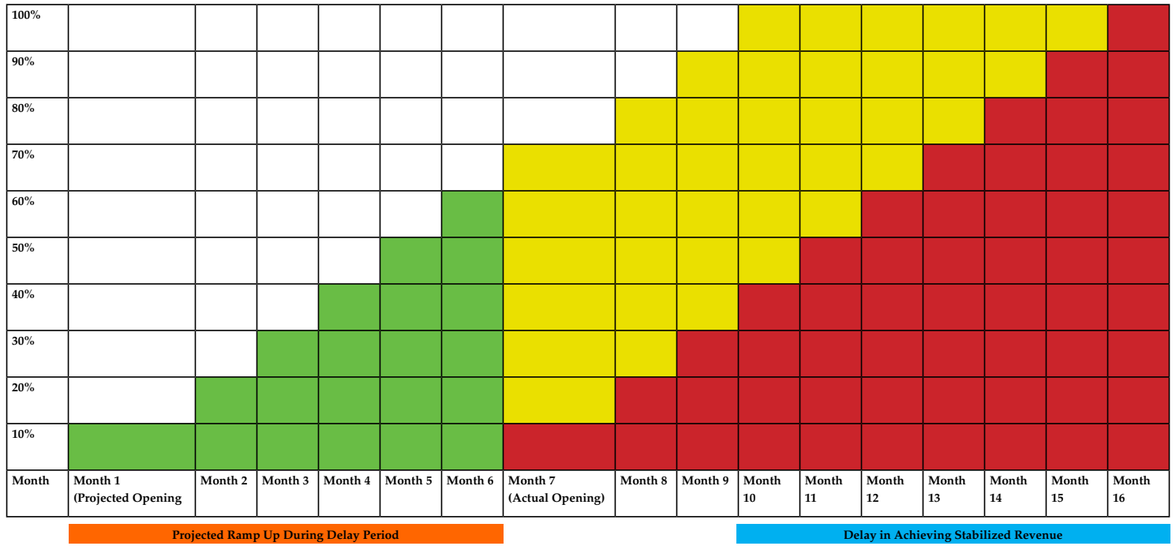
Measuring the Loss
When measuring the potential economic loss(es), it's important to consider the type of business that is expected to be underway once the building is completed. Different operations are likely to have different business cycles. For example, let's say the building is intended for residential or commercial rental units or commercial sales. The normal first step would be to measure the expected stabilized net income for the period of indemnity (the time the insurer must pay after a loss). That's the amount to use to project future lost net income. This approach identifies the full net income that the insured has lost due to the delay in completion of the project. Let us explain further.

Ramping Up
The common sense way to measure the damages might seem to be to consider what the projected net income would have been in the months immediately after the completion of the project. But this would not result in an accurate measurement of the actual damages sustained because it doesn't take "ramp-up" time into account. A ramp-up period is the time it takes from opening a business to when the business is at a stabilized level with consistent sales or rentals. The problem with the "common sense" approach is that when the building actually opens in the future, the business will experience those same number of ramp-up months. Effectively, the insured would go through two separate ramp-up periods; the pre-loss "scheduled" ramp-up period and the "actual" ramp up period post completion. This is illustrated in Exhibit A.

As shown in Exhibit A, if projected net income for months one through six is used, the measurement would not capture a large part of the loss. If you used the projected net income — had the property damage not occurred and compared to the actual net income achieved — there would be a net income loss (highlighted in green and orange in Exhibit A) all the way through month 15. Measuring the projected income for the six months following the loss would overlook the lost income for months seven through 15 (highlighted in orange). Month 16 is when the business is expected to reach its stabilized net income after taking into account the delay period. This is why measuring only the original projected net income during the delay period is not the accurate way to measure the loss.

Typically, builder's risk insurance policies include wording in the "delay" coverage section

Exhibit A - Measured Lost Ramp Up or Stabilized Occupancy Methodology



Shading Representation

Orange - Projected Ramp Up During Delay Period

Green - Anticipated Ramp Up of Net Income had the event not occurred

Red - Hypothetical Actual Ramp Up of Net Income upon completion of the building after the event occurred

Blue - Total Delay in Achieving Stabilized Occupancy

Yellow - If you were to look at Projected Ramp of Net Income had the event not occurred and compared it to hypothetical ramp up that will actually occur, this is Loss of Net Income that would be sustained on a monthly basis

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12	Month 13	Month 14	Month 15	Month 16
Methodology 1: Lost Net Income	10%	20%	30%	40%	50%	60%	60%	60%	60%	60%	50%	40%	30%	20%	10%	
Cumulative Lost Net Income	10%	30%	60%	100%	150%	210%	270%	330%	390%	450%	500%	540%	570%	590%	**600%**	
Methodology 2: Lost Net Income	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%	100%	100%	100%	100%	100%	
Cumulative Lost Net Income	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%	200%	300%	400%	500%	**600%**	

that states, “Damages need to be incurred during the delay period which is defined within the policy.” This is problematic if we intend to measure the difference between projected revenue and actual revenue for months one through 16 when you only have a six-month delay period. This would leave you with 10 months of damages that may fall outside of your delay period.

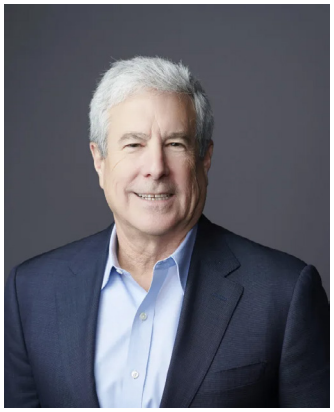
The accurate way to measure this loss — which would avoid this potential problem — is to measure stabilized months that are lost due to the delay in completion of the building. As you can see in our example, had no event occurred we would have reached stabilized net income in month 10. But due to the event, we don’t actually reach stabilized net income until month 16 — six months later than we would if the loss event had not occurred. This period coincides with our delay period and would avoid the potential problem of having damages fall outside of the delay period.

Exhibit A shows another way to consider this comparison. Using Methodology 1, the monthly damages continue at approximately 40 percent of lost stabilized net income for the entire period – six times the monthly stabilized net income. Methodology 2 shows we arrive at the same total of 600 percent by considering 100 percent of lost stabilized monthly net income. Not only does Methodology 2 measure the full amount of the damages, but it also falls within our delay period of six months.

Important Considerations

Calculating lost net income due to a delay in completion on a construction project can be a complex process. There are pros and cons of using different methods. Every project is different and the best way to measure lost net income may vary. We hope this discussion explains important options for you to consider in preparing your analysis.

ABOUT THE AUTHORS



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Mr. Goodman is a nationally recognized public adjuster with over 45 years of experience in adjusting first-party property insurance claims across various industries, including construction, education, health, hospitality, manufacturing, and more. He has managed complex claims for major clients such as Federal Realty Investment Trust, The New School, Combined Properties, MRP Realty & Medstar Health, among others. As a leader in his firm, Harvey specializes in builders risk, large complex claims, insurance coverage analysis, and claim negotiations, and is known for his strategic approach and strong client relationships. He is also a sought-after speaker and writer on topics like catastrophic claim adjusting and coverage gaps. Harvey is committed to charitable causes, has been recognized as one of The Baltimore Daily Record's Most Admired CEOs, and resides in Bethesda, Maryland with his wife.

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