American Insurance Association

LOSS OF USE COVERAGE

Loss of use coverage generally provides protection when a residence cannot be lived in because of an insured loss. Coverage terms vary among insurers, and it is important to review your policy and call your insurer or agent with any questions. The three coverages are called: 1) additional living expense, 2) fair rental value and, in most states, 3) prohibited use. The limit of liability for loss of use shown on the declarations page is the total aggregate limit for these three benefits.

<u>Additional Living Expense</u> - If a covered loss results in the residence premises being unfit to live in, the insurer will cover any necessary *increase* in living expenses to allow the household to maintain its "normal standard of living." The payment will be for the least amount of time necessary to repair or replace the damage or, if the named insured has to permanently relocate, the least amount of time required for the household to settle at another location.

- For example, assume a house has been partially damaged in a fire. Because of the extensive damage, the policyholder is forced to move to a rental apartment on a temporary basis. Their rent is $1,400 per month, which is in addition to the policyholder's $1,100 mortgage payment, which she will continue to pay. Thus, the $1,400 in rent would be considered additional living expenses. If the policyholder's food costs averaged a little higher than they were before the fire, this *additional* amount would be covered as well.

One key question is "what is the normal standard of living"? If the policyholder rented a home with 1,000 more square feet than her current home, the insurer typically would not pay this additional charge. The insurer would insist on a comparable residence to the one damaged, if a comparable residence is available. In addition, any expenses that decrease as a result of the loss, such as utility expenses, would be subtracted from the additional charges.

Note that this coverage is only payable if the damage was caused by an *insured peril*. If the house was uninhabitable due to a flood, a peril typically excluded by a homeowners policy, no loss of use coverage would apply. And, federal flood insurance specifically excludes additional living expense coverage.

Another important point concerns the time necessary to repair or replace the damage. For example, if the home is repaired within six weeks, and the policyholder unnecessarily delays in moving out of the rented accommodations, the extra rent due to this delay would not be covered.

<u>Fair Rental Value</u> - If a covered loss renders portions of the premises that are rented to others uninhabitable, the insurer will cover the fair rental value of such premises.

However, any expenses that will *not* continue or that are reduced while the home is uninhabitable will be subtracted from the additional expenses. The payment will be for the least amount of time necessary to repair or replace that part of the premises rented to others.

- For example, assume the policyholder owns a large home and rents out one of the rooms for $400 per month, which includes utilities. A fire renders the entire house, including the rented room, unfit to live in. The insurer will cover the rental value less any expenses that do not continue (e.g., electricity) while the damage is being repaired. Suppose it takes two months to repair the damage. If the tenant's utility share is usually $30 per month, then the insurer would pay $370 ($400 - $30) x 2 months = $740.

The time necessary to repair or replace the damage is a key factor. If the home is determined to be repairable within two months, and the policyholder unnecessarily causes delays in the start-up construction resulting in a two-week lag, the insurer would not cover the extra two-week rental value.

Again, note that this coverage is only payable if the damage was caused by an insured peril. If the house were uninhabitable due to a flood, a peril typically excluded by a homeowners policy, no loss of use coverage would apply.

<u>Prohibited Use</u> - A civil authority, such as a federal, state, or local government agency or the state police, can prohibit residents from accessing their undamaged homes in a damaged neighborhood or community. (A civil authority could include any federal, state, or local governmental agency.) It is important to remember that an order to evacuate in anticipation of a disaster does not, in and of itself, trigger this coverage. The coverage would not be triggered until there is actual physical damage to the neighboring properties. Some homeowners insurance policies cover the policyholder's resulting additional living expenses and rents or rental value loss under a "prohibited use" provision. This protection is typically good for up to 2 weeks.

This coverage would apply as a result of damage to the surrounding premises, even though the policyholder's own home may be undamaged.

- For example, suppose the policyholder's home is located in a subdivision that experienced extensive loss from a tornado. Numerous homes were destroyed, but the policyholder's home suffered no damage, and it is habitable. However, the extensive damage to the subdivision resulted in the government cordoning off the area for 24 hours. The policyholder's hotel bill, restaurant charges, and miscellaneous expenses for this short period of time would be provided if the policyholder has "loss of use" coverage.

<u>Expenses Not Covered</u> - The insurer will *not* provide coverage for any loss or expense as the result of a cancellation of a lease or agreement. The policyholder could suffer a loss if the tenant's lease was canceled as a result of the property being unfit to live in,

particularly if the lease agreement stipulated this was allowable under these circumstances.

- For example, assume a fire damaged the policyholder's home, rendering it uninhabitable. As a result, the policyholder's tenant moved out and canceled the lease, and it took the policyholder an additional two months after repairs were completed to find another tenant. The homeowners insurance policy will *not* provide coverage for these two months of lost rental revenue. It only provides coverage for the time until the repairs were completed would be covered under loss of use.

Finally, the loss of use coverage provided survives the expiration of the policy. For example, assume the homeowners insurance policy with insurer A expires on December 15, and was replaced by an identical policy from insurer B. A large fire loss on December 11 renders the house uninhabitable for two months. Because the covered loss occurred while insurer A's policy was in force, loss of use coverage will continue under this policy, and not under insurer B's policy.

Again, this paper describes loss of use coverage in a general sense. It is critical that you read your policy and contact your insurer or agent with any questions.

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