

Building Blocks



JLT's Real Estate Insurance Magazine

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Can Political Violence exposure be covered in Australia?

Recent events around the world have generated a number of questions as to how insurance policies will respond to certain types of politically motivated events. JLT revisits the exposure and how these risks may be transferred.

The global financial crisis has had an impact on the level of social unrest in countries where the level of unemployment is rising to dizzying heights. This is coupled with the friction caused arising from other politically motivated groups and extremists. We are now living in a world where tension from one side of the world can promptly trigger the acts locally via the use of social media leading to rapidly developing situations where peaceful demonstrations can quickly become something more sinister if joined by those with other than peaceful intent.

General insurance does not typically respond to either an act of Terrorism or Riot as these are general exclusions from a property insurance policy that property owners rely upon to protect their investments and revenue streams. Whilst there is no coverage within the standard property insurance policies, there are levels of protection provided by the Australian Government and the Insurance Industry to provide the property owner with a level of protection. These include Acts of Terrorism and Riot and Civil Commotion.

Terrorism cover for property owners

A summary of the definition of what a terrorist act is under The Criminal Code Act 1995 includes an action or threat of action where the action causes certain defined forms of harm or interference and the action is done or the threat is made with the intention of advancing a political, religious or ideological cause.

The Australian Government established the terrorism insurance scheme through the Terrorism Insurance Act 2003, to replace terrorism insurance coverage for commercial property and associated business interruption losses and public liability claims. The Terrorism Insurance Act also established the Australian Reinsurance Pool Corporation (ARPC) as a statutory authority to administer the scheme. The scheme commenced on 1 July 2003.

Until then insurers had excluded liability for terrorism losses by including clauses to that effect in their insurance contracts. The Terrorism Insurance Act overrides those terrorism exclusion clauses in 'eligible insurance contracts' where they are considered 'eligible terrorism losses' arising from a 'declared terrorist incident'. Insurers may reinsure this additional risk with ARPC.

The Terrorism Insurance Act covers contracts that insure:

- loss of, or damage to, eligible property that is owned by the insured;
- business interruption and consequential loss arising from loss of, or damage to, eligible property that is owned or occupied by the insured or an inability to use such property; or
- liability of the insured that arises out of the insured being the owner or occupier of eligible property.

This however does not extend to include coverage for Residential Property owners as residential properties are not covered by the Terrorism Insurance Act. For Residential Property owners some of the Strata Insurers and General Insurers are starting to again provide an element of cover for Terrorism. These are typically minimal limits of \$1m and \$2m depending on the building's location. It is likely that in the next few years we will see insurers in Australia increasing their limits for terrorism and the affordability of this cover.

Riot and Civil Commotion cover for property owners

A summary of the definition of what a terrorist act is under The Criminal Code Act 1995 includes an action or threat of action where the action causes certain defined forms of harm or interference and the action is done or the threat is made with the intention of advancing a political, religious or ideological cause.

Riots and Civil Commotion can have a direct impact on property owners in many ways. Some examples are:

- Properties being set on fire and windows smashed in order to steal goods resulting in potentially significant property damage and rental losses if the abatement clause of the lease is triggered.
- Properties being damaged and business trading interrupted following police lockdown in response to extremely large numbers of rioters in the area.

- Rioting over an extended period of time resulting in property owners facing significant interruption to their businesses due to denial of access/reduced trading and property damage.

The most basic cover is available by a write back for Strike, Riots and Civil Commotion. The write back simply cancels the standard exclusion of these perils in conventional property and cargo policies, in exchange for additional premium, thereby providing cover for strike, riot and civil commotion. Many disturbances in recent times may appear to fall within the definition of a riot or civil commotion.

An alternative option is to purchase a Political Violence insurance policy which will provide comprehensive coverage tailored to the risks the business faces. This coverage can include Strikes, Riot, Civil Commotion, Terrorism, Sabotage, Insurrection, Revolution, Rebellion, Coup d'etat, War and Civil War. These policies are particularly important if your Australian domiciled companies are trading or investing in other parts of the world especially in the emerging markets.

In Australia, we have experienced extremists participating within demonstrations which have ultimately led to dangerous riot situations and the Australian Government believes that Australia is now a target of transnational extremist groups. The National Terrorism Public Alert System, which is run by the Australian Government, currently, at date of publication, maintains an alert level of 'Medium' dictating levels of precaution and vigilance to minimise the risk of a terrorist incident occurring. (Source – <http://www.nationalsecurity.gov.au/>)

JLT's strategic solutions for Political Violence and Political Risks

JLT has vast experience in arranging the appropriate Political Violence and Political Risks solutions to suit the needs of any business and has one of the most successful political/credit risk teams in the markets handling in excess of US\$60bn in premiums at any one time.

Drawing on our political and credit risk experience, JLT has developed the World Risk Review, a strategic decision making tool designed to help corporations, banks and other organisations involved with international trade and investments. It provides a short to medium term assessment of the level of risk associated with a range of political and economic perils that could cause financial loss and is the most comprehensive risk assessment tool of its type.

Nine perils are rated in 197 countries and territories under the broad categories of Political Violence, Trading Environment and Investment Environment. This provides a starting point for clients to devise effective strategies to manage these risks with greater granularity, rigor and sophistication.

The World Risk Review website includes your personal ratings table, historical ratings, user ratings, country comparisons, key insights and country reports, heat mapping and user opinion and discussion blog.

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Risk Management for Property Owners

Featured in the September 2012 edition of Australian Property Institute

In 2010, a well-known organisation embarked on a major investment by acquiring an old warehouse with the intention of developing the site for residential accommodation. Through their due diligence it was identified that the site had, as part of its history, been used for printing and publishing. Although management undertook a high level risk assessment of the acquisition, focus was largely on the financial viability of the development, rather than a wide-ranging assessment of the risks which may have potentially impacted the investment. This narrow focus on the venture's potential risks would come back to haunt them.

Within nine months of the purchase, site excavation led to the discovery of the presence of toxic levels of PBTs, halting all development. The property was ultimately sold at a substantial loss and remains undeveloped today. This story of an unsuccessful investment would no doubt strike a chord with many Commercial Real Estate (CRE) owners and managers; reflective of failed investments which may have been avoided if a more rigorous risk assessment process was undertaken.

Development of a risk register, where the risks are identified and quantified, is an essential process for any CRE portfolio which should be re-tested

against each new investment. Risk management for CRE is a mature discipline, with many owners / managers having developed robust processes to minimise risk to their organisation. This article provides a high level overview of some of the more traditional risks CRE owners and managers face, together with other emerging risks and some tools available to manage them.

For the sake of brevity, JLT has grouped risks into three main categories – Property and Business Interruption, Liability and Commercial Risks. It is also convenient to group risk treatments into four general areas:

Treatment(s):

Risk avoidance - action is taken to simply avoid or remove the risk;

Mitigation - implementing controls which seek to minimise or reduce the risk exposure;

Risk transfer - the risk is transferred contractually or otherwise to another party; and

Risk finance - the risk is financed through either funding or insurance.

Property and Business Interruption Risks

Increased Insurance Taxes - The Victorian Government proposes to abolish the Victorian Fire Services Levy (FSL) on 1 July 2013, to be replaced by a levy via council rates, spreading the cost against a broader base and lowering the cost of insurance. In the interim period, certain FSL levies have been increased, making the cumulative impact of all government charges in excess of 100% of the base premium in certain instances. **Avoid (if possible)**. If you have property insurance covering Victorian properties expiring between 1 July 2012 and 30 June 2013, avoidance of double fire-service related charges may be possible if your insurer allows you to pro-rata the FSL applicable.

Natural Catastrophe Risks - Natural Catastrophe activity over the past few years has heightened the exposure of properties in earthquake and flood zones with increases in property

insurance premiums and deductibles and reduced policy limits. **Mitigate, Finance**. Mitigation of risk by proper design and physical protection of CRE properties in exposed locations is key. Ensuring adequate insurance protection is purchased is essential – cover, valuations, business interruption reviews and policy limits are key focus areas. Insurance costs can be minimised by working with your broker to “sell” your risk to insurers. Preparation for major weather events is also essential to protect life and property. Having a current Crisis Management Plan which responds to weather and other catastrophic events, accompanied by staff training, is paramount.

Climate Change, Fire Risk - Climatologists are currently predicting a potential reversing of our climate from La Niña (characterised by high rainfall in Australia) to El Niño, marking a return to drought conditions. The result is a period of prolonged vegetation growth, followed by a prolonged dry spell resulting in high fire fuel loads and, hence, fire risk to properties. **Mitigate, Finance**. Treatment is one of prevention,

removing fuel loads surrounding property, as well as ensuring that adequate sprinkler protection systems are in place both inside and, where appropriate, outside the premises (rooftop). When all else fails, close scrutiny of your property and business interruption insurance, well before you sight the encroaching bushfire, is advisable.

Damage to unoccupied properties

- Unoccupied properties pose an increased risk of damage for property owners and insurers. The current business environment can lead to increased vacancies depending on the property and surrounding economic environment. **Mitigate, Finance**. Prevention of damage is the primary protection. Owners facing long term vacancies need to take appropriate measures to reduce risk of damage through vandals. Long term vacancy of a property is generally deemed to be a fact requiring material disclosure to an insurer. Failure to implement adequate prevention measures may also make it difficult to insure the property, or result in increased cost.

CONTINUED OVERLEAF.

Liability

Gradual Pollution - Strict liability on property owners for environmental contamination. **Avoid, Finance.** The best defence is undertaking adequate due diligence to avoid 'surprises'. Historically, environmental insurance was relegated to specialist insurers providing limited protection to owners for liability or clean-up costs. Major insurers now offer bespoke, broad coverage with realistic limits at very competitive prices. If your decision not to insure against this exposure goes back a few years, it may be worth your while reinvestigating.

Slips and Trips - Liability arising out of injury through slip, trips and falls is typically a chronic risk for CRE owners / managers. Unfortunately, there appears to be a growing trend for increased public liability claim costs in this area. Add to this our courts' relaxing attitudes to tort law reform, and proceedings where workers' compensation claim costs are recovered against a CRE owner's / manager's public liability insurance.

Avoid, Mitigate, Finance, Transfer.

Property owners and managers have many tools in their arsenal to mitigate exposure in this area including:

- Analysis of incident / claims, their cause and identification of trends and implementing corrective measures
- Ensuring any slip or trip hazards are identified and rectified
- Protocols and training including inspection programs, signage and use of sheaths for wet umbrellas
- Developing incident and claim intervention strategies
- Thinking long term – developing strategies that will have lasting impact
- Transferring risks under contractual arrangement.

Legionella - A familiar risk which potentially exposes building owners and managers to significant liability, including potential injury or death and

Mitigate, Finance.

economic loss. Adherence and monitoring of inspection and maintenance regimes is essential, as is an appropriate crisis management plan. Again, public liability insurance provides an essential backstop if all else fails.

Crisis Management - CREs have an obligation to personnel, contractors and third parties to protect them from injury. **Mitigate, Finance. Prevention,** proper planning and training are paramount. Owners / managers should have an up-to-date Crisis Management Plan documenting procedures for each site for major events such as weather, fire, earthquake, etc. At the end of the day, such losses can be potentially catastrophic in nature and having adequate public liability insurance is important.

Commercial Risks

Liquidity - Liquidity remains a high risk concern for property owners and developers. The banking sector in Australia has not fully recovered from

the Global Financial Crisis with debt facilities for new developments difficult to raise without a substantial balance sheet, a solid business plan and pre-committed sales. **Mitigate, Finance.** Ensuring that potential purchasers and tenants have the financial capacity to underpin their contractual obligations with developers / owners is vital. Often these obligations should be supported by substantial means such as through bank guarantees, credit insurance or surety bonds over the tenure (or part thereof) of the agreement.

Capital Diminution - Decline in commercial property values. **Mitigate.** Avoiding a downturn in CRE values requires substantial foresight. Generally CRE owners need to have the financial capacity to 'ride out' the cycles of the property market, however, the impact can be diminished by ensuring that you invest in prime investments where lease or rental returns (and hence values) are less volatile.

Loss of Tenancies - There is clear evidence that on-line shopping will ultimately cause a quantum shift in market dynamics, changing buyer

behaviour. **Mitigate, Finance.** It is difficult to mitigate risk in the long term unless CRE owners / managers adapt their property portfolio. However, short to medium term risk mitigation strategies could include:

- Changing the selection criteria of tenancies. Identify businesses which are adapting well to the on-line shopping threat.
- Ensuring that the tenancies have adequate collateral to withstand a poorer trading environment.
- Seeking stronger guarantees from tenants to pay rent.

Risk Management builds resilience

The risk for CRE property owners / managers is an evolving one with constantly increasing and more onerous regulatory and governance requirements. The impact of climate change will continue to be felt. Strategies must be developed to

combat some of the emerging, more chronic commercial risks which may have some short term solutions, but in the longer term may only be treated through a change in the commercial property landscape.

In our experience, effective risk management enhances an organisation's resilience and preparedness against the impact on its health and reputation as well as its financial, operational and environmental success. Developing risk strategies and treatments can prevent or mitigate these risks to a tolerable level.

An effective risk-management strategy is therefore a vital component of successful property management. Not only does it make accidents or losses less likely, but it can help property owners and managers sleep better at night.

For more information contact Stephen Cooper on +61 (0)2 9290 8123 or email Stephen.Cooper@jlta.com.au



A Risk Manager's Perspective...

The protection of assets against loss, damage and destruction, and the continuity of rental income, has always been of significant importance to property investors. JLT's European Real Estate team employs an ex-industry property investment risk manager, John Searing, who shares with us some practical risk management tips for property investors...

Traditionally there has been a reliance on managing agents and property managers, along with the relatively infrequent surveys performed by insurers, to manage risk and recommend improvements. Although not wrong, there are a number of shortcomings with this approach:

1 Insurers primarily undertake these surveys for their own purposes – e.g. Reinsurance (insurance for insurance companies), estimated maximum loss calculations, checking sprinkler systems still qualify for reduced insurance ratings, etc. Also, it is rare that insurers make their full report available for clients.

2 Insurers will normally issue a list of risk improvements. However, these will usually be limited in their usefulness in terms of a comprehensive client driven risk management program, since more often than not they will be focussed purely on fire risks and will fail to comment on

the management of other risks such as liability, engineering, business continuity and reputation.

3 Often the site visits of insurers are based on an annual timetable commencing at renewal. Therefore, they only see each property at a similar time of year, thus missing seasonal variations in the risk profile of properties.

4 Most insurers focus on the physical aspects of risk and whilst significant, JLT feels it is also critically important to review wider risk management aspects such as procedures, systems, documentation, training, etc.

5 We believe that an insurer's annual survey, in isolation, is not really adequately managing the risk. This is something which should be done, and should be evidenced as having been done, on a day to day basis, 24/7.

6 Managing agents and on-site property managers might then seek to take this role on. However, this is something which is not usually a core part of their offering and in our experience, they do not usually have the focus on risk, the training or the systems to adequately meet standards of best practice.

Your insurance broker should be able to provide additional assistance to improve the adequacy of your risk management framework. By employing a structured risk management programme property owners are able to fully understand the exposures of their operations and maximise the impact of their risk management strategies. Risk management and audit programmes should include Occupational Health and Safety reviews, environmental risk reviews, insurable risk profiling exercises, incident management system improvements and claims management reviews. At JLT we include these services under our Property Risk Audits and our Public Liability Risk Audits.

Why is this more important now?

The list of concerns, issues and topics to which property investors need to respond is constantly expanding. This is no less the case within the area of risk management, where there now needs to be added focus on subjects such as:

- a) Protecting brand and avoiding damage to reputation.
- b) Demonstrating added value and peer group differentiation to occupiers and prospective occupiers.
- c) Health and safety and the management of liability risks to avoid the huge financial fines and penalties available to courts.
- d) Other additional legislative requirements such as fire risk assessments and asbestos registers.

- e) Possible increased voids due to occupier bankruptcies, requiring improved risk management techniques to satisfy insurer's requirements.
- f) Assisting with the broking of the insurance program in a hardening market with insurers requiring clients to demonstrate that they have a wider structure and a more proactive approach to the management of risk, so as to reduce claims or maintain them at acceptable levels.

JLT recognises a strong risk management culture provides for the successful management of a real estate investment portfolio. JLT's Real Estate team in Australia works closely with the European team to share risk management strategies and has

collectively established a framework for property investors through a system of risk auditing.

JLT employs over 100 specialist consultants nationally with extensive experience and expertise in Risk, Occupational Health & Safety and claims management across Australia. Should you wish to learn more about JLT's Property Risk Audits and our Public Liability Risk Audits please contact Stephen Cooper.

For more information contact Stephen Cooper on +61 (0)2 9290 8123 or email Stephen.Cooper@jlt.com.au

Construction Insurance For Property Developers

Property owners are all involved in development work of some sort whether minor repair and renovation projects or ground up developments. It is important to consider your options when arranging suitable cover.

The standard Industrial Special Risks (ISR) insurance policy will provide minimal coverage against minor construction activities as long as the policy has not been amended. The ISR generally allows works up to a value of \$500,000 before the contract works exclusion kicks in. Above that amount, a separate contract works insurance policy should be purchased through a broker experienced in dealing in Construction Insurance. Construction Insurance can be arranged by either the Principal or the Contractor depending on a number of factors. Here we examine in more detail insurances arranged by the Principal.

Benefits of “Principal Arranged”

It is becoming increasingly common for construction insurance to be “principal arranged” as developers want to maintain control of the insurance coverage arranged on their projects. A principal controlled program will clarify who is responsible for what, avoid wasted cost in terms of superfluous cover being purchased, and give certainty and control to the developer when the project is most risk exposed.

Other benefits of principal arranged contract works insurance include:

- 1 It will allow your broker to provide better advice on cover, as they will be involved over the whole life of the project, not just before it commences and after it is completed.
- 2 The importance of maintaining control over the insurances to enable the Principal to structure the insurances in accordance with their objects and risk tolerance. Contractors may purchase insurance with significant retentions which may not be suitable to your business.
- 3 Greater control over the financial security of the insurer as this is chosen to meet the requirements and criteria of the Principal rather than the contractor who may purely be driven by price.
- 4 Improved administration as there can be difficulty and cost in controlling a large number of contractors and sub-contractors' insurances. The process of checking and administering contractors' insurances can be time consuming and may lead to items being missed or not insured correctly.
- 5 It will ensure that construction policies phase in with subsequent operational policies to take the pressure off the Practical Completion dates especially for phased development sites.
- 6 The ability, to comply with financiers' requirements enabling the Principal to control the process.
- 7 Protection of the Principal against the Contractor becoming insolvent as the Contractors insurance will be invalidated and the contract works will be uninsured.
- 8 Providing the Principal with the knowledge that the insurance premiums have been paid and the premiums to be paid in instalments should they choose.
- 9 Providing the Principal the option to purchase Advance Business Interruption insurance should the project be delayed generating a loss. Without control over the insurances it becomes questionable whether this insurance can be purchased on a standalone basis. If available the Principal will have no say over the carrier as it will need to be the same as the Contractor and may not be desirable to the Principal.
- 10 The claims process is more streamlined by eliminating the opportunity for disputes between different insurers (and loss adjusters) and claims monies are paid direct to the principal, removing the accumulation of deductibles.

Components of the cover

The traditional construction insurances for property developers which can be arranged on either an annual or project basis include;

Contract Works – physical loss and/or damage to the permanent and/or temporary works.

Public Liability – legal liability to third parties for personal injury and/or damage to property.

Advance Business Interruption – loss of anticipated revenue/profits and/or holding costs and/or other additional costs incurred as a result of a delay in completion of the works caused by physical loss and/or damage insured under the Contract Works policy.

What else is important to consider?

In addition to taking control of your insurances it is important to engage an

insurance broker who is well versed and experienced at arranging Construction insurance policies. When arranging Contract Works insurance you should ensure your broker is a construction insurance expert and is able to:

- Analyse all relevant contractual requirements, e.g. construction, sub-contract, funding, etc.
- Draft contractual insurance conditions
- Liaise with contractors, suppliers, consultants, joint venture partners, financiers, etc.
- Prepare underwriting submissions for insurers
- Market the project to specialist construction insurers
- Negotiate with insurers to secure cover at optimum terms and conditions
- Produce project insurance and claims procedure manuals

Other construction insurances which JLT can assist with include;

- Professional Indemnity – whether on a project or annual basis
- Construction Plant & Equipment
- Workers' Compensation
- Home Warranty

- Delay Risks – such as liquidated damages and force majeure insurances
- Residual Value Guarantees – a bespoke product structured around the project funding arrangements
- Environmental Impairment/ Pollution Liability

JLT has an established national Construction division which provides specialist insurance broking and consultancy services for Property Developers. Working with the JLT Real Estate team, the JLT Construction team offers you access to an extensive selection of insurance products and services which range from traditional to innovative. We have considerable experience placing insurances for Property Developers on a “principal arranged” basis.

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