

RM Insight[®]

Property Insurance – A Broker's Guide to Understanding Occupancy

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Insurance with insight

Understand occupancy and the associated risks

The first in a four part series, this guide is to help you understand COPE (construction, occupancy, protection, exposures). Historically, property underwriting has focused on COPE as the core principal of risk assessment.





What is occupancy and the influence upon underwriters?

It's what goes on inside the premises... the business activity. For example:

- product manufacturing
- assembly of components made elsewhere
- product storage and distribution
- an office/administration
- accommodation
- education
- food services
- goods displayed for sale (i.e. retail).

The occupancy can influence the exposure to loss. Research of large fires in Australia shows that certain occupations have unique frequency and severity of loss exposures. The exposure in the recycling industry is a case in point.

These exposures can either be fire inception, and/or propagation hazards. For example, an inception hazard is when a fire starts from the failure of an excess temperature cut-out on a heating process and ignites nearby combustibles. A propagation hazard is when a fire occurs (from whatever cause) within high-piled storage of plastic bottles for example and spreads through the premises with ease due to the combustible nature of the product and the open stacking.

The greater the risk of loss, the closer the underwriter analyses the business activity (i.e. occupancy). An office for example, presents less of an operational hazard than does a motor vehicle paint and body shop. The office would therefore attract a more favourable premium.

Beyond merely knowing the insured's operations, the underwriter also considers how the insured manages those operations. Similar insureds do not necessarily manage operations in the same manner. Since each insured manages its exposures and hazards differently, each has its own 'occupancy hazards' that would be considered in the underwriting process.

Some insurance companies will refer to 'inherent hazards' when discussing occupancy. Inherent hazards are those associated to the business activity and could well be unique to that occupancy such as metal recycling that has had much in the way of media attention in the last decade or so. Health care facilities such as hospitals with reticulated oxygen for example, have an increased risk.

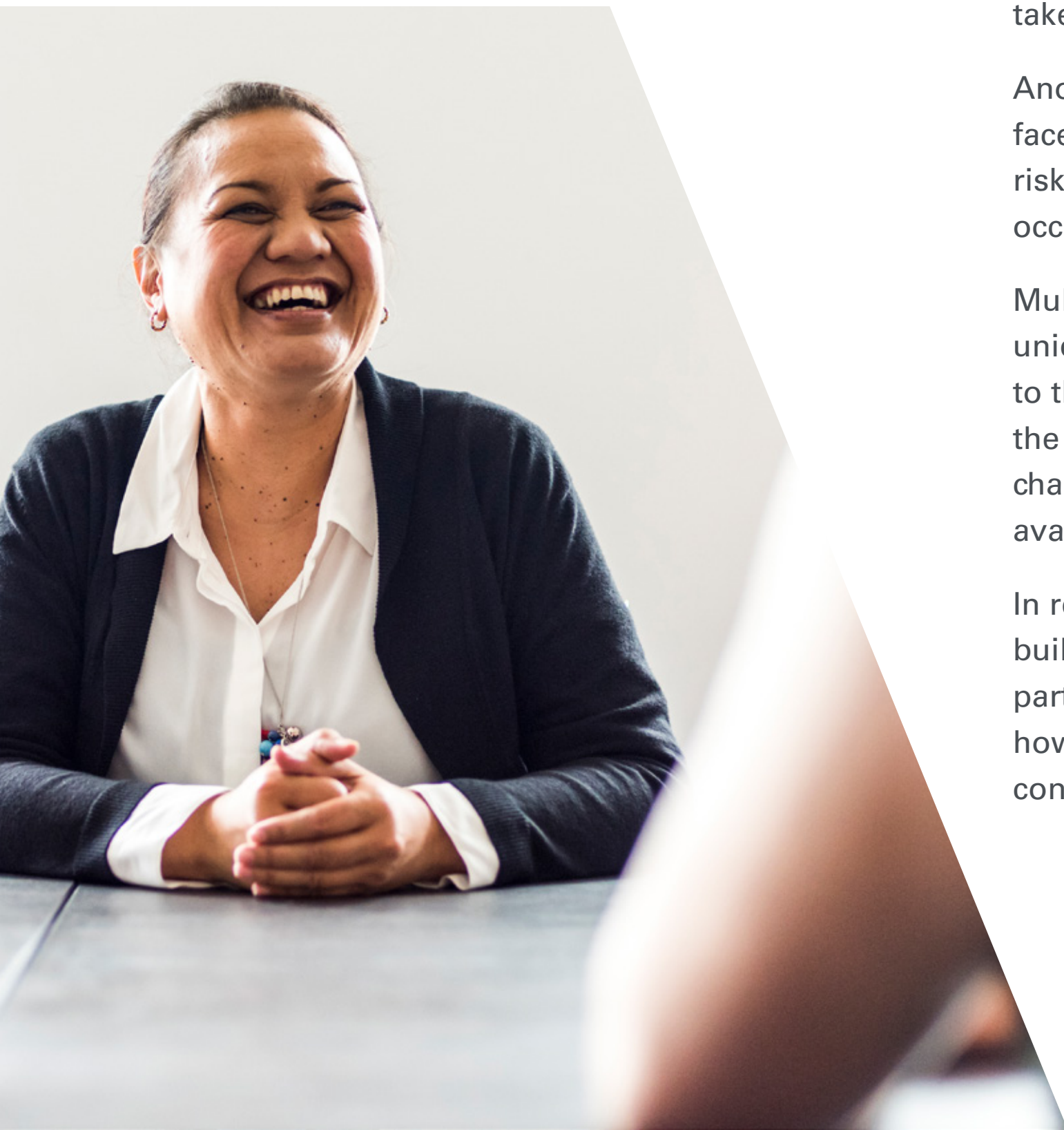
What are ANZSIC Codes and their application?

The Australia and New Zealand Standard Industrial Classification (ANZSIC) system classifies entities based on their main business activity and is typically used to collect and analyse data across industries. One of the main users of ANZSIC codes is the Australian Taxation Office (ATO).

The insurance industry has adopted this system with unique variations such as applying their own individual codes (inclusive of cross reference to ANZSIC codes in most instances) and selecting those that apply to their individual book of business (favourable or unfavourable).

Each code has undergone intense background analytics that would influence the insurance offering. For example an office occupancy will be of a far greater attraction to an insurer than a plastic bottle manufacturer.

Overall, applying the correct code to an occupancy provides consistency of insurance offerings and subsequent portfolio performance.



Understanding the risks associated to an occupancy

Many insurance companies have authored their own 'risk profiling' style literature based upon experience (e.g. Factory Mutual) to firstly understand the intricate details of occupancy and the associated risks inherent to that occupancy.

Others reference third party organisations and their respective database such as LMI Risk Coach. LMI Risk Coach (www.riskcoach.com.au) was conceived in 2004 to provide a local version of the US derived "Bests Guide". The Bests guide has long been used to understand specific occupancy exposures.

It is important to note here that unoccupied premises present a unique risk that is typically not attractive to an insurance company. Refer to our RM Insight article 'Protection of Unoccupied Buildings'.

Further, it is not unusual for an occupancy to change over time. For example with COVID-19, many organisations are pivoting to survive. Dine-in restaurants are now providing takeaway meals.

Another organisation that made clothing, now makes face masks. A change in occupancy may influence the risk profile. Refer to Appendix A for an example of an occupancy and risk profile.

Multi-tenanted premises such as factory units present a unique risk profile as each tenant will have hazards unique to their occupancy. Underwriters need to understand the tenancy of all units and in turn need to be advised of changes to tenancies as they occur. Changes could affect available capacity for insurers.

In respect of property owners, the insured owns the building and leases out the space to one or more third party tenants. The underwriter needs to understand how the insured manages the tenants regarding risk control/management.

How would you find out about your clients occupancy?

Ask them!

You will find that many business owners and managers are happy to discuss their activity as they are proud of their achievements and products. Some may have process flow diagrams or may just list the main processes during discussion.

They may take you on a tour of the premises. At this time, it's a good idea for them to walk you through the process from incoming raw materials, through to conversion or processing and then into the finished goods in storage, which is awaiting distribution.

Brokers should realise, a degree of occupancy knowledge will be needed to complete the insurance proposition slip.

As stated previously, there is the LMI Risk Coach which will provide a pretty good picture of occupancy and associated risks.

It's always a good idea to read up on this (and other literature sources) before going to your client. At least some knowledge will provide you with a 'head start' and indicate to your client that you are interested in their business.

Don't forget an internet search. However be careful... a lot of what's out there can be someone's opinion rather than fact.

Check the sources!



Other aspects of occupancy to consider

Consider the following, as each will influence the insurance proposition.

How long has the business been operating:

Established businesses are typically a more attractive insurance proposition. 'Start-ups' are unknown and not proven, thus presenting unique exposures. Many insurance companies 'shy away' from businesses with less than 12 months history.

Changes to occupancy:

While change is inevitable and a natural evolution of many businesses, a high frequency of change infers that the business is not sure of its direction and thus continually searching for that prime opportunity. A stable business activity is a more attractive insurance proposition.

Storage:

Most occupancies involve the storage of raw materials and/or finished goods. Consider the extent of storage (i.e. typically expressed as a percentage of the overall floor area), the type of goods and how these are stored. For example, plastic bottles in cardboard cartons on timber pallets, within double row racks to a height of 5m over 50% of the floor space.

Hazardous goods (e.g. flammable/combustible liquids):

Consider the type, quantity and storage of the goods. For example, 5,000 litres of petrol in 205 litre metal drums stored within a designated flammable liquid store and detached from the main building by 25m. The store incorporates a bunded floor and there are no electrical systems within.

Sole occupancy or not:

Is the insured the sole occupant of the premise or do they co-exist with third parties? The third party may present more risk than the insured.

Presence of ignition sources:

This could include ovens, deep fryers, conveyor systems, materials handling devices, refrigeration equipment, production machinery etc. Focus on any protection devices and alarms incorporated within.

Computer systems:

Do these support production or just administration and finance? What are the back-up and recovery options? As technology develops, risks increase or decrease.

Storage of perishable goods (e.g. foods and medical supplies under refrigeration):

Consider construction of the storage facility (i.e. insulated sandwich panelling), the refrigeration equipment type (inclusive of maintenance regime), temperature controls and alarms. Unfortunately, a lot of refrigeration equipment does not receive maintenance. It's a forgotten item of plant and just runs until it breaks down. Focus on formal maintenance programs.

Plant, machinery and equipment:

Underwriters would be interested in an inventory listing all items which includes name, age, use and values. Information on maintenance and obsolescence are critical to the underwriting process. An item that is obsolete may be difficult to replace.

Dust extraction:

In some occupations, this system is critical to maintain an acceptable housekeeping level (e.g. woodworking) and brings forth its own risks.

Goods movement:

Electric, gas or diesel fuelled forklifts. These include a variety of fire inception hazards.

Electrical system:

Age, condition and maintenance inclusive of thermal imaging. Review hazardous areas requiring special electrical systems. This is a focus area for many underwriters considering the risks that have been posed by electrical systems over the years.

Business interruption

Can be a complex subject... Consider the following, as each will influence the insurance proposition.

Purpose built buildings:

Such as a premise designed for the production of computer chips (includes clean-rooms, special purpose air-conditioning etc.) or cold storage facilities built of combustible sandwich panelling.

Consider the existence of alternate premises, alternate source of supplies and interdependency.

Machinery and equipment:

Maintenance, spare parts, replacement lead-times and obsolescence as previously noted.

Hours of business:

If the premise is running 24/7, there is not much more room for them to increase production following some down-time/interruption.

Other business locations:

Highlight the duplication of activities and any interdependencies where one premise feeds to another for example. A loss of a key premise may influence the overall production.

There may also be a third party premise that supply key products or items. Overseas locations also present unique exposures as their supply to the local entity may incur border restrictions/closures/higher costs etc.

Resources

Internet based risk management and insurance resource.
Factory Mutual Global Property Loss Prevention Data Sheets.



Appendix A

An example of 'occupancy and risk' for a swimming leisure centre follows (property risk only):

Occupancy

Public swimming pools are often part of a larger leisure centre or recreational complex. For the purpose of this article, we refer to the facility as a leisure centre.

A leisure centre incorporates one or more bodies of water primarily for bathing and can provide for co-existing activities in the water, on the surrounding land and within the associated building infra-structure.

Specifically, the bodies of water (i.e. pools) provide for a vast array of water borne recreational activities such as swimming, diving, paddling, wading and health related events such as therapeutic and rehabilitation exercises. The centre may provide events for local school carnivals, swim clubs, competitive squad and elite sports training. Depending on the event, it may co-exist with the general public recreational activities or may be exclusive to the entire centre. There may be owned and council operated physical assets or assets leased to third parties like a food and beverage outlet, gift shop or function centre.

Pools may also include diving boards and platforms, water slides, a wave simulation area, splash pads and any body of water may be heated.

The surrounding land and within adjacent buildings may also include health related activities such as yoga, aerobics and dance classes. There may also be gymnasiums, saunas, steam rooms and spas within. Leisure activities may include celebratory functions such as birthday parties or business functions within a building, under a shade structure or in a cordoned off land area.

The centre would include public services of a general nature such as toilet and shower facilities along with personal belonging lockers and change rooms, barbeque provisions with adjacent picnic/seating, cabanas and function rooms.

Some environments such as the barbeque and picnic/seating areas which are typically open sided, may be covered with shade sails or more permanent impervious roofing material.

Completing the occupation profile would include administration offices, public services/enquiry areas, general goods and food storage rooms including cool rooms and freezers with associated refrigeration plant, first-aid room and child minding facilities. There may also be display cabinets for various trophies and shields and an adjacent car park.

Peak occupation is typically in the summer months and in winter the centre may be utilised for non-water based events and/or activities as previously noted.

Causes of loss

As one would expect, public liability losses within this leisure centre sector abound with unfortunate events such as slips, trips and falls along with drownings. As previously noted, this article focuses on events resulting in property damage and subsequent business interruption. In terms of frequency (number of unfortunate events), the top five causes of loss in leisure centres follow with reference to risk mitigation material;

- Failure to secure the premises resulting in theft of own or third party goods/property, fire and/or malicious damage to own or third party property (i.e. goods in care custody & control). Refer to the checklist 'Providing and maintaining premise security', the RM Insight article 'Protection of unoccupied buildings', the RM Insight article 'Arson prevention' and the RM Insight article 'Security alarm monitoring'.
- Failure to maintain mechanical/electrical plant (includes refrigeration plant) resulting in breakdown and/or catastrophic failure. Refer to the checklist 'Maintaining mechanical and electrical plant' and the checklist 'Inspection and maintenance of refrigeration plant'.
- Failure to manage contractors resulting in fire/explosion. Refer to 'Risk information – Property...Contractor management' and the checklist 'Contractor engagement and safe work'.
- Failure to manage hazardous goods (e.g. water treatment chemicals) resulting in fire/explosion. Refer to the checklist 'Managing hazardous substances (chemicals)' and the RM Insight article 'Labelling of hazardous chemicals in the workplace'.
- Failure to manage flammable and combustible liquids resulting in fire/explosion. Refer to 'Risk information-Property... Flammable and combustible liquid hazards'.

Discover how our expert Risk Management team can help you at

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