

COMMERCIAL STRATA EXPLAINED

Many factors affect the type and cost of insurance for commercial strata properties.

There are also ways strata committees and strata managers can reduce tenants' impact on the broader insurance program.



The insurer's perspective

Insurance is about the transference of risk. When insurers look at a property, they do two things.

1. Evaluate risk, ie the likelihood of a claim.
2. Calculate the premium needed to cover the costs associated with the perceived risk, ie the reinsurance costs.

The higher the risk, the lower the insurer's risk appetite, which can result in a higher premium or no offer of cover.

Commercial properties have unique risks

Commercial strata properties include office spaces, retail outlets and industrial units. These are often located within larger complexes, such as shopping centres or industrial warehouses, where individual units are owned separately.

The tenants in these properties can vary widely, and so can the level of risk they present to insurers.

- An **office** is typically a low-risk business activity, with predictable business hours and limited equipment onsite.
- **Restaurants and food manufacturers** with cooking equipment and high foot traffic would be considered high-risk tenants. The manufacture and storage of goods can be a more volatile risk, leading to greater loss potential, simply because of the materials used.
- Similarly, **warehouses or factories** that store hazardous and flammable chemicals and materials and rubber products, or those that carry out "hot work" with boilers or pressure equipment, like **mechanics and electricians**, are high risk.

Finding the right tenants

Tenants are a significant factor in insurers' assessment of the overall risk associated with commercial properties. High-risk commercial tenancies within a strata property can significantly increase insurance premiums. This increase is driven by both a higher frequency of claims and heightened moral risk associated with potential criminal activity.

Here are some of the most common risks associated with commercial tenants.

Property damage

- **Theft and vandalism.**

High-risk tenants, such as tobacconists and convenience stores, are prime targets for theft due to the high value of their stock, particularly cigarettes and tobacco products. Additionally, high foot traffic and the nature of activities in adult service venues increase the likelihood of property damage. This, in turn, raises the possibility of break-ins and vandalism.

- **Fire hazard.**

Some tenants carry a high fire risk due to the storage and sale of flammable products. Improper disposal of smoking materials can also lead to accidental

- **Major incidents.**

Types of businesses linked to illegal activities such as drug use, human trafficking or other illicit operations can see frequent major incidents, such as arson, armed robbery or police disturbances, often leading to insurance claims.

Loss of rental income

- **Damage causing vacancy.**

Extensive damage to a property may force the tenant to vacate, leading to a loss of rent.

Liability risks

The risk is not only about damage to the building. It also relates to the increased risk of liability, including death, injury, and third-party property damage that might result from the tenants' occupation

- **Legal issues.**

High-risk businesses may face frequent legal challenges or compliance issues, which can lead to potential lawsuits and increased legal fees for property owners.

- **Disagreements.**

High-risk tenants may be more likely to experience customers or employees being injured on the property. Any serious injuries could lead to potential legal action.

A closer look at the impact of defects

Insurers want to keep customers who represent a "good risk". That means a property that's well maintained and has a good claims history.

Owners have a statutory obligation to repair and maintain their property, address issues as they arise, and prevent problems caused by neglect.

If an insurer requires a customer to rectify issues as a condition of insurance, it's now insisting that rectification work is underway before it will accept the ongoing risk at renewal. Customers are likely to be asked to provide evidence that active steps have been taken to rectify the cause of a defect.

Customers should ignore this at their peril. Doing nothing can come at a considerable cost to the strata scheme.

- Less choice of insurers
- Higher insurance premiums and excesses
- Imposed conditions of insurance
- Reduced level of insurance cover
- Claims declined
- Difficulty selling the property

What this means for insurance premiums

- **Higher risk assessments.** Insurers assess the risk levels of the tenancies within a strata property. High-risk businesses increase the overall risk profile, resulting in higher premiums.
- **Risk selection.** There's a very limited market for strata insurers willing to provide cover for high-risk activities. Many buildings with high-risk tenants or activities are finding it increasingly difficult to secure the required legislative insurance in the current market.
- **Frequent claims.** An increased number of claims, both in frequency and severity, directly correlates with higher insurance costs.

How do insurers assess commercial strata property?

Every insurer is slightly different, but these are some of the main criteria insurers consider.

- Tenants' business activities
- Building location and age
- Construction materials
- Security measures, like alarms, surveillance cameras and fire protection measures
- Claims history

Improving your risk profile with insurers

There are simple ways to present a property in the best possible light, which can improve access to cover and potentially result in more competitive terms and premiums, particularly for low-risk tenants.

- **Proactively identify risks.** Conduct thorough risk assessments to consider both the internal and external factors that may impact a property and the tenant's business activities.
- **Investment in risk mitigation.** Consider implementing better security systems, practical fire safety measures and creating a regular maintenance plan to keep the property in a good state of repair.
- **Employee training.** Ensure employees receive regular training on safety protocols and risk prevention. Fewer workplace accidents can lead to lower insurance premiums.
- **Be transparent.** Be open and honest about your risk profile and mitigation strategies with your broker and insurer

If you have any questions about strata insurance for commercial properties, please contact your local BCB office.

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