

Client Advisory: Real Estate

The shocks from the Covid-19 pandemic continue to greatly impact the Real Estate industry, and will continue to do so for some time to come. Much conjecture centers on how Real Estate will be used, and this will certainly mould future developments.

Shift from Traditional to Flexible Working

While claims surrounding the end of offices are likely mistaken, some changes will persist. The 9-to-5, five-day workweek was already evolving and this change has been fast-tracked. Flexibility, in some form, is here to stay.

Vast numbers of office employees in central locations provide a captive audience for restaurants, gyms, and an array of services, which must now adapt to changing circumstances. By the same token, residential communities on the fringes of big cities may require an enhanced local offering throughout the working week. Opportunities for mixed-use developments may re-shape our built environment.

Pandemic Risks

The onset of a pandemic may not have been entirely unexpected. Some organizations, such as the World Economic Forum, previously highlighted this possibility, but the world was still largely unprepared. Public and private entities may have been aware of the risks, but they did not fully account for it. In the search for growth, and with strong competition, risks may be underestimated or discounted.

In the public sector, some governments had run simulations and stocked up on medical supplies and protective equipment. However, following the global financial crisis, capital was deployed elsewhere and stocks were run down. The lesson to private enterprises is one that should be heeded as we prepare for whatever lies ahead. In Real Estate, forecast returns prior to investment must be risk-adjusted.



Climate Change and Property Damage

Climate change, and the more frequent extreme weather that it causes, is not an unexpected risk. Moreover, aside from the threat posed to people and communities, it presents serious repercussions for Real Estate values. Occupiers have become more aware of the role Real Estate plays in their Business Continuity Plans, particularly as a result of the disruption the pandemic has brought. As such, buildings with a higher degree of resilience will be in greater demand, leading to higher rental levels and capital values. On the flip side, buildings that don't score well on resilience will not only command lower rents but will also suffer from higher maintenance costs.

In the face of multiple risks, building greater resilience is critical to the Real Estate industry. So how do we prepare?

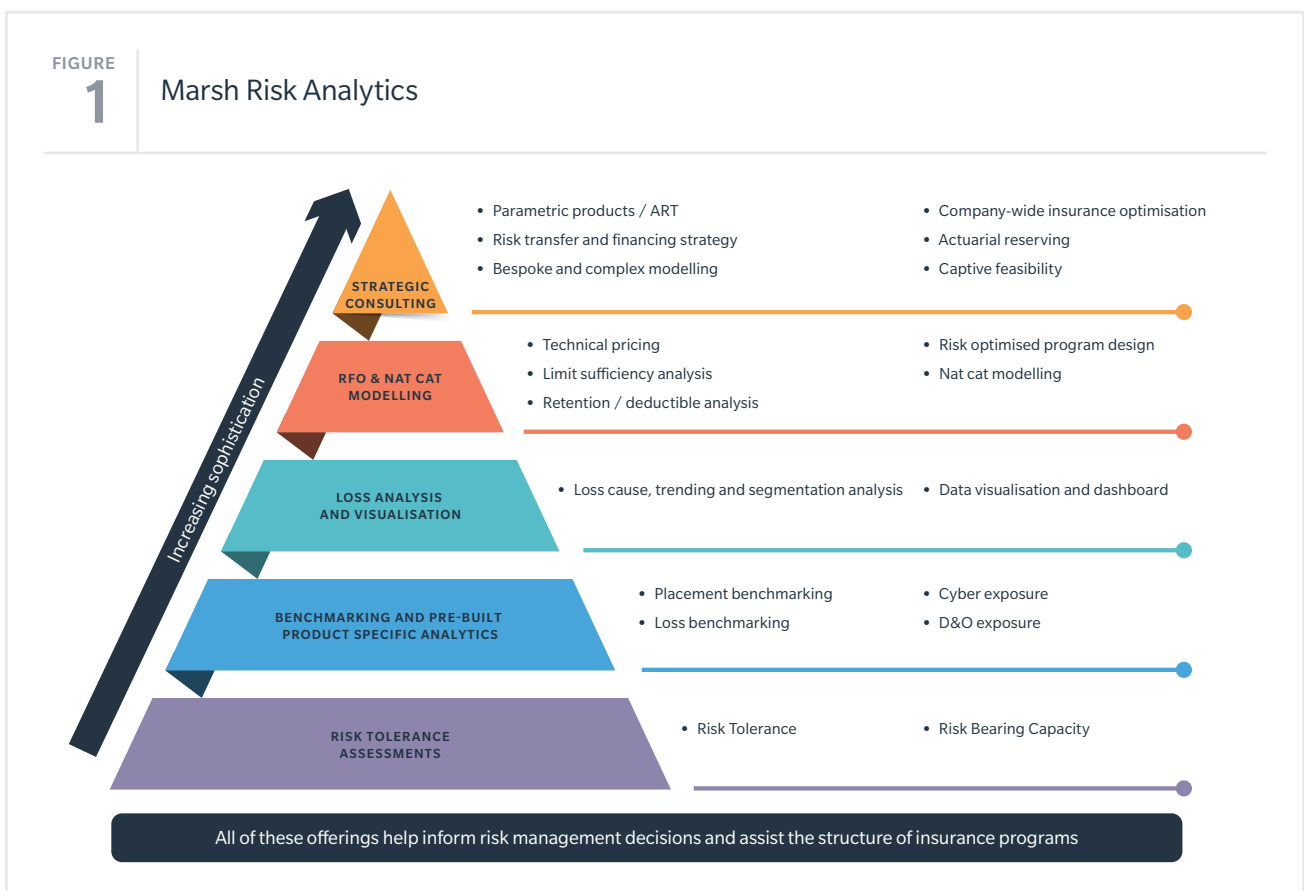
Financing and Managing Risk

Preparedness

More frequent and more severe weather events are leading to greater losses being borne by insurers and higher costs for insureds. Multiple annual losses have given rise to increased premium levels and reduced coverage. In addition, insurers are increasingly asking the insured to absorb part of property risk themselves through higher deductibles or self-insured retentions.

We also see a more acute focus on data and the diligent maintenance of records. Insurers will insist on, among other things, accurate loss records and updated values. They will also insist on the application of average relief clauses, where an insured must bear a rateable proportion of their losses when the loss exceeds a certain percentage over the declared values.

We can utilize data and analytics to examine historical losses, benchmark, and assist in calculating the right level of risk to retain or transfer. The following chart provides an overview of services that can assist in making informed risk management and insurance purchase decisions.



Risk financing or insurance alone is sometimes not sufficient to provide adequate loss protection. Insurers will ask for updated risk surveys, and follow-ups on risk recommendations, highlighting the need for a broader approach to risk management. Moreover, most property insurance policies stipulate that the insured has a duty to mitigate its loss and may be penalized by insurers in the form of a reduced claim payment if found to have failed to do so.

Risk can be managed to reduce the frequency and severity of losses, and to get assets back up and running sooner, and this begins prior to development or acquisition. Natural Catastrophe (NatCat) modelling can be used to identify potential exposure to extreme weather, earthquake, and floods, allowing resilience to be incorporated into construction design for project future-proofing.

In Natural Catastrophe modelling, we assist clients to employ a four-stage approach by first taking a look at the exposure of the assets, its related hazards, and then formulating a response to such events and working out their financial impact.

FIGURE
2

Natural Catastrophe Modelling Methodology



More extreme weather events are changing flood plans and our experience shows that floods have caused some of the largest losses, heightening the need for a full assessment of flood exposure for individual sites. This prudent approach allows for resilience-adjusted valuations to be measured against investment criteria, and for informed decision making. Looked at in a different way, should a property lack resilience it will suffer increasingly higher risk finance costs, and impaired valuations.

Business Continuity & Crisis Planning

One of the outcomes emerging from the pandemic is greater risk awareness among users of Real Estate and a renewed focus on Business Continuity Plans. We see a flight to quality as occupiers demand greater resilience from buildings. They seek environments where employees feel safe, and physical and operational factors that facilitate business continuity. This increase in risk awareness is not related solely to pandemics but is more broad-based in the face of multiple risks.

For example, in recent years, we have seen an increase in social unrest in some locations and some high profile terrorist attacks. While these events may be relatively rare, viewed in a pan-Asian context, their impact can be extremely damaging, to people, property, and business operations. Loss of revenue can be significant and immediate, while loss of confidence in an asset or location can have lasting effects. Real estate firms cannot eliminate these threats but they can take steps to reduce risk, contain the damage when it does occur, and accelerate recovery.

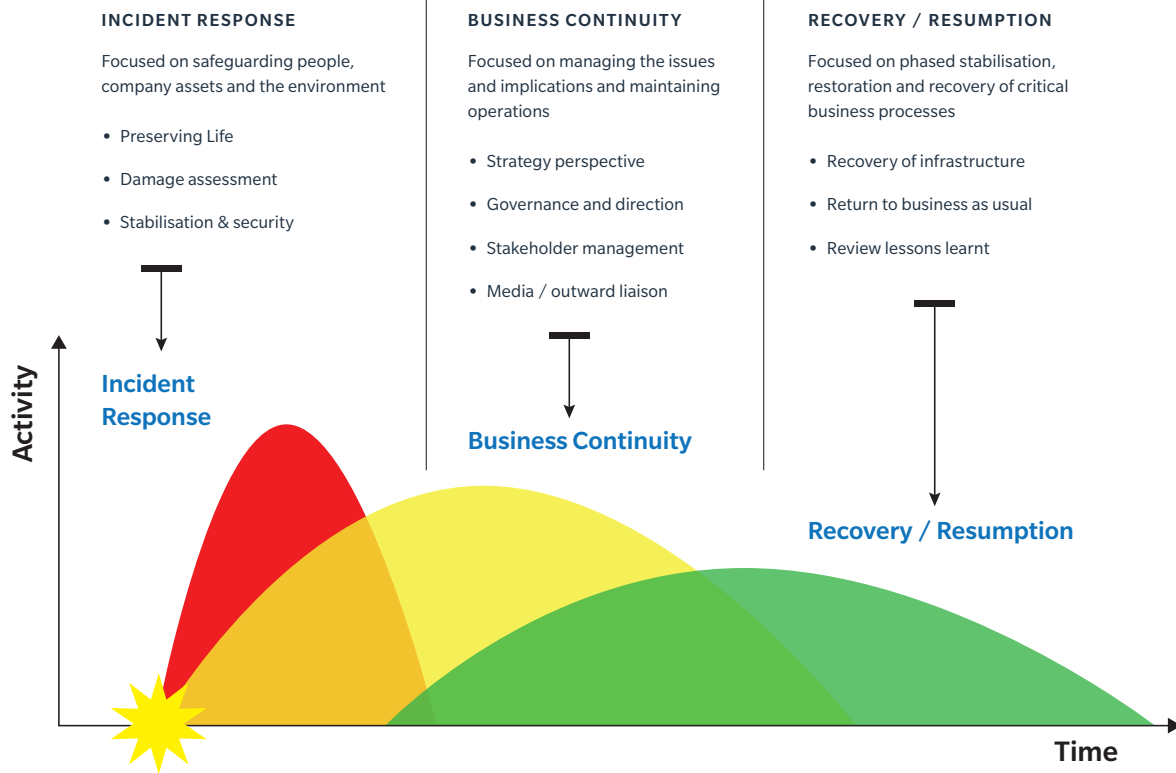
The loss of market share and positioning, missing a window of opportunity, damage to reputation, and inconveniences are among the many hidden costs that cannot be indemnified by insurance. Pro-active risk control should therefore be adopted as the first line of defense in protecting the interests of stakeholders. Organizations can take steps to be prepared to respond, remediate, and recover, thereby becoming more resilient. Resilience, therefore, should not only be an intrinsic feature of assets, but also ingrained into organizations. This helps to manage loss events when they do occur, reducing the severity and enabling more rapid recovery.

This requires Enterprise Risk Management processes to be embedded into organizations. A Security Vulnerability Assessment is the first step. Its objective is to identify and understand hazards, and manage the associated risks through prioritization and the allocation of appropriate resources. This process should calculate an Estimated Maximum Loss, to guide the implementation of improved risk mitigation measures and security controls, in accordance with a property owner's risk profile and tolerance levels.

To improve business resilience, a Business Continuity Management Plan should be developed, incorporating emergency response and business recovery protocols. This establishes the priorities, objectives, and required supporting hard and soft infrastructure to provide safety and effective communication throughout a crisis. It is imperative that the plan is maintained and regularly tested to identify weaknesses and allow for appropriate updates, therefore improving effectiveness.

FIGURE
3

Emergency Response



How Marsh can help

Insurance placement

Marsh assists its clients in demonstrating a proactive approach to risk management, placing particular care in highlighting an insured's resilience. As such, we make sure to help our clients differentiate, in order to achieve terms that are better than its peers. Through its centralized placement team, Marsh has access not only to the local insurers, but also to regional and global insurers, and will use all the leverage that it possesses to obtain superior terms and coverage with 'A'-rated insurers.

Risk finance

Marsh leverages its analytics capability to ensure that placement decisions are aligned with our clients' risk tolerance. Our Risk Finance Optimisation (RFO) studies help make optimal decisions about how insurance is used, assisting in all stages of insurance program design and placement.

By supplementing real loss data with comparable industry peer claims from Marsh's proprietary Loss Data Library, we model a robust picture of potential large losses. Using this insight, together with other variables, we are able to estimate the economic cost of risk on different insurance structures, to arrive at the optimal outcome for our clients relevant to their risk profile.

Risk mitigation

Marsh offers a complete range of highly-specialized, innovative solutions that support the full spectrum of risk management – from strategy and planning, to analysis and design – throughout the Real Estate cycle to preserve and enhance value.

We apply NatCat computer modelling software to quantify loss exposure from natural hazards. This provides a better understanding of the severity and likelihood of extreme losses, and allows clients to score locations by loss exposure and to incorporate the results into their risk-adjusted investment decision making.

Marsh also leads the way on Fire and Life Safety (FLS) Audits, which verify designs, review installations, and conduct functional testing of FLS systems. Our audits are based on internationally accepted standards and industry best practices, helping to identify critical deficiencies to the FLS systems prior to investment, and therefore helping to prevent losses arising out of fire and life safety incidents.

Enterprise level

Marsh's Crisis Management Planning enhances crisis preparedness capability and a culture of prevention at enterprise level. We assess and benchmark crisis management plans and procedures against best practices and industry standards. We also validate that established plans enable management to respond to any issue or event and manage it effectively, thereby avoiding a full-blown crisis. Not only does this raise risk awareness throughout an organization, but it also reduces response time to a crisis, and therefore its impact.

Claims

When a loss does occur, after providing real time advice in the immediate aftermath, our number one priority is to ensure our clients obtain the best possible claim outcome under their insurance policy. We advise on many aspects of a loss, including clean-up operations, temporary protection, preparing the claim, and, in particular, negotiating with insurer representatives. We represent our clients' interests with insurers on any difference of opinion or interpretation issues of insurance policies.



Our experienced property claims advocates assist in reporting, coordinating, and negotiating settlement of your loss with insurers and/or the loss adjuster. However, the Marsh Claims Solutions team works significantly beyond the traditional scope of broker claims support by affording our clients access to experts specializing in advocacy, business interruption, and property claims preparation. This also helps address the imbalance between insurers (who draw on their own experts in almost all claims) and our clients.

For the latest information on what actions can be done to manage risk effectively, and how your assets can become more resilient, please contact our industry and advisory professionals.

EDWARD FARRELLY
Real Estate Industry Leader, Asia
Edward.Farrelly@marsh.com

DARRICK CHEUNG
Client Engagement and Development Leader, Asia
Darrick.CH.Cheung@marsh.com

Disclaimer: Marsh is one of the Marsh & McLennan Companies, together with Guy Carpenter, Mercer and Oliver Wyman. This document is not intended to be taken as advice regarding any individual situation and should not be relied upon as such. The information contained herein is based on sources we believe reliable, but we make no representation or warranty as to its accuracy. Marsh shall have no obligation to update this publication and shall have no liability to you or any other party arising out of this publication or any matter contained herein. Any statements concerning actuarial, tax, accounting or legal matters are based solely on our experience as insurance brokers and risk consultants and are not to be relied upon as actuarial, tax, accounting or legal advice, for which you should consult your own professional advisors. Any modeling, analytics, or projections are subject to inherent uncertainty, and the Marsh Analysis could be materially affected if any underlying assumptions, conditions, information, or factors are inaccurate or incomplete or should change. Marsh makes no representation or warranty concerning the application of policy wording or the financial condition or solvency of insurers or re-insurers. Marsh makes no assurances regarding the availability, cost, or terms of insurance coverage. Marsh's service obligations to you are solely contractual in nature. You acknowledge that, in performing services, Marsh and its affiliates are not acting as a fiduciary for you, except to the extent required by applicable law, and do not have a fiduciary or other enhanced duty to you.

Copyright © 2020 Marsh LLC. All rights reserved. www.marsh.com

PH20-1621