

The Changing Face of Retail and its Impact on Property Protection

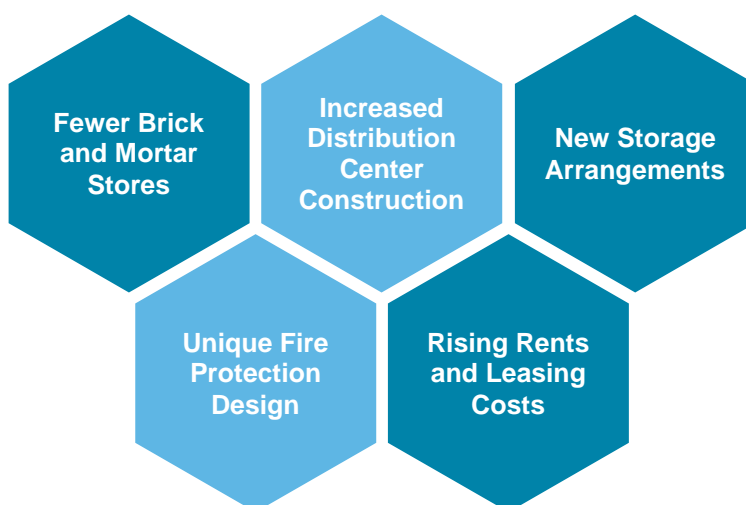
Aon Global Risk Consulting
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The past few years have seen significant changes in the way that people purchase retail and consumer goods. Increasingly, shopping is performed online. Current statistics show that in the first quarter of 2018, 9.5% of total sales were on line, and increase from 8.5% in the first quarter of 2017 (US Census Bureau, May 17th 2018) – and this reality has forever changed the face of Main Street and once-booming suburban shopping malls. Historic retailers and department stores are struggling to meet shareholder expectations and are closing stores. Other retailers are transitioning operations to Internet-only e-commerce sites to reduce expenses associated with brick-and-mortar stores.

In the digital age, stores must adapt to the evolving needs of consumers and provide a unique “customer experience”. These new strategies include hands-on experiences such as classes, special events, exercise activities, wine-tasting events, or extended store hours to allow customers to browse or demo merchandise at their leisure.

The shopping habits of Millennials are also impacting retail. Many Millennials browse at traditional brick-and-mortar stores but ultimately purchase online. The sharing economy, along with the trending minimalist lifestyle, has resulted in retailers adopting a “rental” approach to clothing and durable goods. Amazon and other e-commerce retailers now serve as online, customer-centric retail alternatives by leveraging reviews, easy exchange policies and a plethora of offerings. This all serves to underscore the expectation that by 2020, online sales will account for at least half of all retail purchases.

From a property protection perspective, this retooling of the retail industry poses a range of challenges. With the reduction in the number of stores, which are often leased from one of the large mall operators, to an increased number of warehouse distribution centers, the digital environment has indeed changed the property risk landscape for retailers.



How do these new realities impact retailers?

In 2017, more than 247 million square feet of new warehouse space – in the form of new distribution centers (DCs) and fulfillment centers (FCs) – was added in the marketplace. These warehouses are either owned or built-to-lease for specific retailers to meet growing distribution and fulfillment needs. Rents and leasing costs at these new and existing facilities continue to rise. As these new facilities come online, property risk control consultants are engaged to ensure that fire protection systems are adequate to the risk, and that to ensure they are properly installed, code-compliant, and have properly implemented maintenance schedules.

In this new era of retail, it is important that retail risk, property and warehouse managers are aware of the new challenges facing their facilities and operations are ready to meet new fire, safety and code regulations. The following procedures and practices warrant close consideration moving forward.

Reviewing and surveying the warehouse location

During the due diligence phase of facility planning, it is critical to have a risk control consultant or engineer involved in the review of the site options for facility locations. Looking at past flood history, along with Natural Catastrophe exposure, property risk control consultants can advise retailers of risks and help the retailer select the best location to locate their warehouse or DC, to ensure minimal risk from any Natural Catastrophe and reduce insurance premium. These consultants can also support development and optimization emergency response plans for any hazard that may be a potential issue for the new location, whether it is flood, fire or seismic exposure.

In the design stages, the risk consultant's review can include construction and wall system design (critical in cold storage warehouses); insurance MFL capacity reduction by wall or physical separation; protection of openings for lift truck traffic and conveyors through fire walls; roof system wind design for Tier I and Tier II wind locations; HVAC installation; seismic bracing of racks/sprinklers; seismic shutoff valves, etc. Each of these items should be a key consideration in the decision-making process for the location of the facility.

In any new location, the risk control consultant can provide advice as to the adequacy of any public water supply and whether a fire pump and tank will be required to provide an adequate and reliable water supply.

Reviewing the commodity classification of warehouse inventory

During the design stage of the project, the commodities that are being stored are reviewed, and the commodity classification should be reviewed by a risk control consultant. The commodity classification review must include the packaging and shipping container. Once the commodity class is confirmed, the actual fire sprinkler design criteria can be developed before the building design is finalized. Due to the dramatic changes in inventory or lack of on-hand information, retail goods are sometimes classified incorrectly, resulting "over-protected" inventory, which can lead to increased insurance costs. Conversely, if commodities are under-protected, retailers risk inadequate fire protection in the event of a loss, and the loss may not be fully covered by insurers. Both of these scenarios can ultimately be costly and lead to significant additional costs to remedy once the product is in the warehouse.

Aon property risk control consultants seek to mitigate fire risk, and thereby exhibit due diligence to our clients, which may potentially lead to reduced premium payments. One obvious way to mitigate risk is to ensure that

the sprinkler protection is properly installed and meets the desired standards (National Fire Protection Association, FM Global or other standards).

Often there are simple, cost-effective strategies that can be implemented. For example, aerosols and flammable liquids can be stored in one area to reduce the need for in-rack sprinklers or higher demand ceiling sprinkler protection throughout the entire building. Aon's risk control consultants work with clients and insurers to identify the most cost-effective fire protection to save clients significant money by implementing strategically sound and innovative designs.

Reviewing the storage array

Just as the consumer-side of retail is changing, the way that items and inventory are stored is evolving. Retailers are looking for new innovative methods of storing product in order to take advantage of available (or unused) space and move product through the warehouse quickly.

Innovative storage solutions may require unique fire protection solutions. Aon has worked with a number of retailers to provide innovative unique fire protection that provide the following solutions:

- Protects the product,
- Ensures code compliance
- Meets insurers' and fire department's needs

Prior to racking installation, it is important to fully understand how the design will be laid out; whether there are shelves or not; and ensuring there are sufficient flue spaces to allow water from the ceiling to penetrate throughout the storage array.

In the design stages, the engineer's review can include construction and wall system design (critical in cold storage warehouses); insurance maximum foreseeable loss (MFL) capacity reduction by wall or physical separation; protection of openings for lift truck traffic and conveyors through fire walls; roof system wind design for Tier I and Tier II wind locations; HVAC installation, seismic bracing of racks/sprinklers, seismic shutoff valves, etc. Each of these items should be a key consideration in the decision-making process for the location of the facility.

Working with the sprinkler contractor to ensure NFPA or FM Global standards are met

It's critical that sprinkler contractors install the sprinkler system that was agreed to in the design phase. Generally contractors are not aware of the nuances of the codes that risk control consultants are aware of. This can result in items improperly installed or omitted from the system. Aon property risk control consultants serve as the client's advocate and will review drawings to ensure compliance with standards; carry out site visits to ensure correct installation as well as provide a final acceptance test to ensure that the installation meets the approved designs.

Ensuring facility personnel are familiar with all human element programs

Once the facility is built and product starts begins to arrive at the location, it is vital that facility personnel are aware of the steps that they need to take to ensure that the likelihood of a loss is reduced. Human element programs are vital to ensuring that fire protection systems are properly maintained and operating efficiently, as well as critical to ensuring risk of fire is minimized through adequate control of ignition sources. Aon can provide training to maintenance related to human element programs such as:

- Hot Work
- Manual Fire Protection
- Inspection, Testing & Maintenance of all fire protection equipment
- Impairments

It is imperative that a systematic and frequent maintenance review process is put in place. It is important that the maintenance staff is aware of the maintenance and inspection procedures they need to implement to ensure the maximum uptime of the fire protection systems. In short, protection systems need to operate properly in the event of a fire, flood or other loss event.

Conclusion

Aon property risk control consultants work closely with the facility management and risk management teams to ensure that in the event of a disaster, the emergency response plans trigger and respond effectively. This process often includes Business Continuity Planning steps to ensure that other distribution centers can provide support and take over the roles of the impacted DC.

Major changes in the retail industry have not only affected consumers. The impact on property portfolios has been monumental. With the increase in the number of DCs and FCs and the recent changes to some protection standards, it is now more important than ever that retailers engage with a Property Risk Control Consultant who is not only familiar with client facilities and the standards they need to meet, but also in-depth knowledge and experience of what insurers and local Fire Marshals will accept. Aon has a team of consultants skilled in the specific retail risks that are ready to assist with these issues.

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