Real Estate Insurance Market Under Pressure

Current Trends & 2023 Outlook

FEBRUARY 2023

Over the past five years, the real estate property and casualty insurance market has been challenging, as industry losses have impacted insurance carrier capital and profitability. While the property market is currently front and center, the casualty lines continue to see upward rate pressure albeit at a moderating pace.

The following summarizes the current state of the insurance market for companies across the real estate industry.

Although overall market trends are important to understand, the individual attributes of a specific insurance buyer or asset are what drive results. For example, market segment (commercial versus residential), geography, natural catastrophe exposure, construction type, deductibles, valuation and losses all are critical to determining renewal outcomes. Support from experienced and knowledgeable brokers can also contribute to more favorable results.

Property insurance: How did we get here?

The combined effects of three inflection points over the past five years have helped create a property market that can be exceptionally difficult for real estate industry companies.

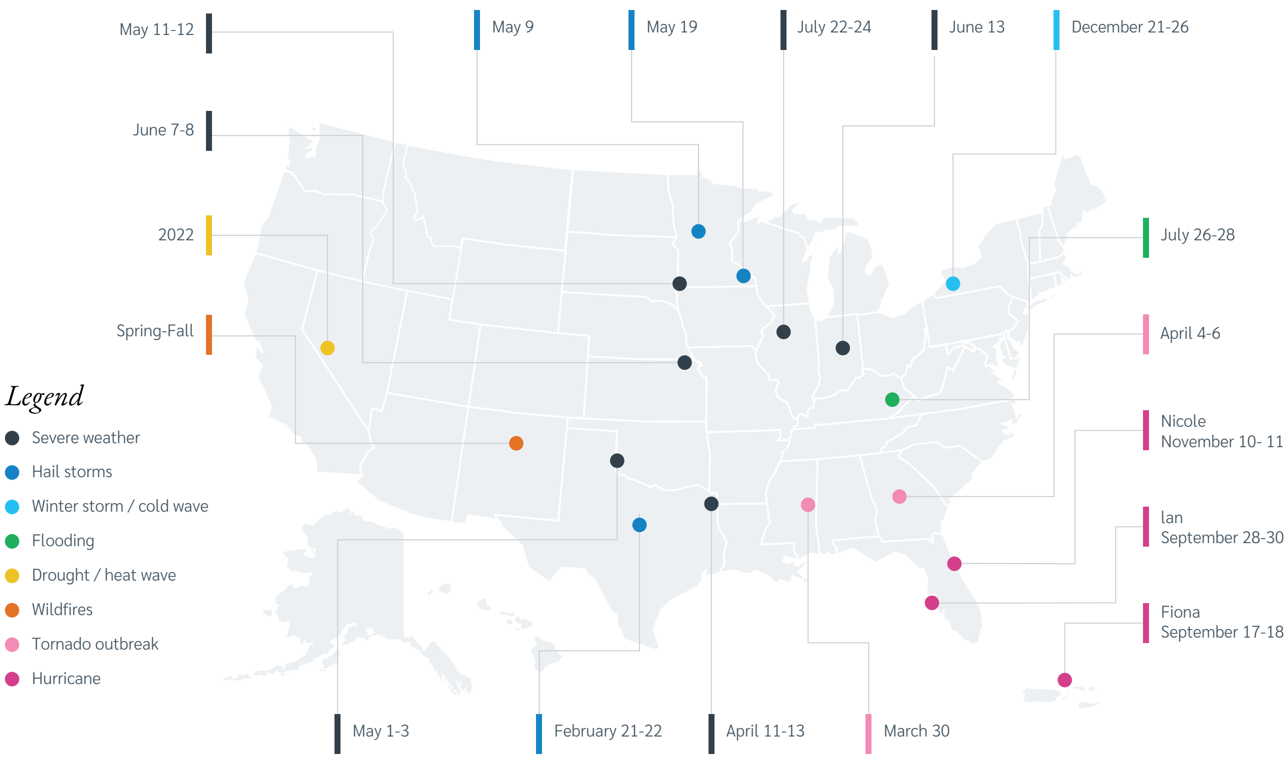
1: Hurricanes Harvey, Irma and Maria

- The destruction caused by Harvey, Irma and Maria across Texas, Florida, and Puerto Rico in 2017 was the start of a period of historically high catastrophe loss trend for insurers.
- Accumulating losses from these events, along with inflation, low interest rates and other macroeconomic headwinds, have resulted in the steady erosion of capital in the insurance and reinsurance markets.

2: Hurricane Ian

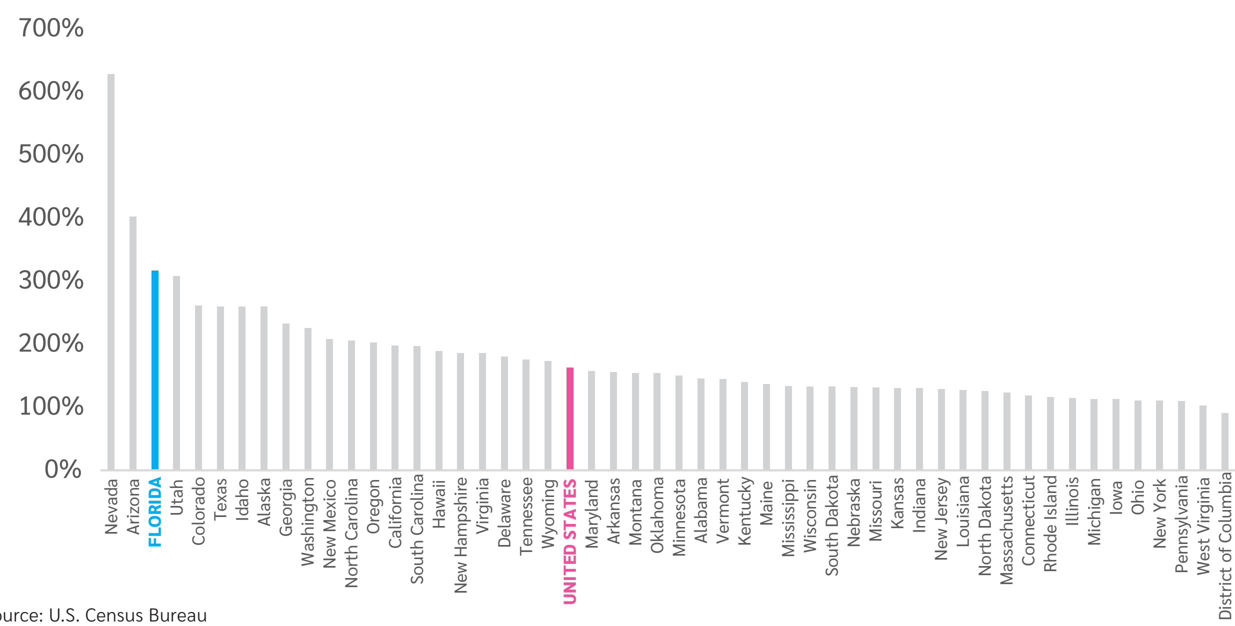
- Hurricane Ian represented a significant event for an industry that was already under stress.
- Changes in the primary and excess property insurance market are being driven by adverse post-Ian developments in the reinsurance marketplace, which insurance companies access to move portions of their own risk off their balance sheets.
- This has led to significant increases in premium and deductibles, reduction in limits offered (capacity) and coverage restrictions. At January 1, reinsurance rates jumped between 45% and 100%.
- Increases in the frequency and severity of weather events have led to significant losses for insurers and uncertainty in the marketplace:
  - According to the National Oceanic and Atmospheric Administration (NOAA), 18 separate natural catastrophes across the U.S. resulted in total economic losses of at least $1 billion in 2022 (see Figure 1).
  - Insured natural catastrophe losses have topped $100 billion in three calendar years since 2017, which has raised concerns that insurers' models will not keep pace with the growing frequency and severity of catastrophes amid climate change.
  - The destructive power — and high cost — of hurricanes, in particular, has been fueled by greater development and higher population density in coastal areas over the past five decades. For example, both the total population and population density (measured as people per square mile) of Florida increased 317% from 1970 to 2020, according to data from the U.S. Census Bureau (see Figure 2). That's the third-largest growth rate among U.S. states and twice the overall national growth rate.

FIGURE 1: NEARLY 20 BILLION-DOLLAR WEATHER AND CLIMATE DISASTERS WERE RECORDED ACROSS THE U.S. IN 2022.



Source: National Oceanic and Atmospheric Administration

FIGURE 2: FROM 1970 TO 2020, FLORIDA'S POPULATION DENSITY GREW AT TWICE THE NATIONAL RATE.



Source: U.S. Census Bureau

3: Skyrocketing replacement cost valuations

- Given the losses the insurance industry has seen over the past 5+ years combined with inflation, supply chain issues and the escalating cost of construction, there is greater scrutiny on accurate reporting of values. Often, these are underrepresented by 30% or more relative to the actual cost to repair and replace damaged property.
- Property insurance premium is calculated on a rate x value basis, so the increase in values has an additive effect on premium. For example, a 15% valuation increase plus a 30% rate increase drives a 49.5% premium increase!
- Underwriters are requiring buyers to thoroughly evaluate their portfolios and make specific adjustments to the valuations of individual properties. Evaluation tools include third-party valuation services, such as Marshall & Swift, and site insurance replacement cost appraisers. Failure to adjust values to market can result in a carrier adding restrictive coverage endorsements, such as occurrence limit of liability (OLLE) and margin clauses that limit the amount a carrier will pay for damaged property. This can result in an organization being underinsured, potentially in violation of lender requirements.

Given these challenges, the overall rate environment for real estate-specific property is severely challenged, especially in Florida and Texas and along the Gulf Coast. This has caused a bifurcated market between catastrophe-exposed and non-CAT-exposed business with negative risk attributes such as older frame, challenged loss history, and undervalued assets seeing the highest double-digit increases.

The current imbalance in the supply of insurance for the most CAT-exposed assets versus the demand for such insurance will continue to put upward pressure on renewal programs with those attributes. The continued volatility in the market could further increase the benchmark rate range of 10% to 50%+, subject to actual client geography, exposures, deductibles and losses. Valuation change is additive to premium and currently in the range of 10% to 30%.

General liability insurance

General liability (GL) rate increases are expected to moderate in 2023 after years of double-digit increases. This is due in part to the cumulative impact of historical rate increases, along with higher deductibles for many buyers.

The combination of rate, higher retentions, and a greater focus on loss prevention/mitigation of loss for premises-related claims — for example, slips and falls — are getting closer to neutral. The current rate increase benchmark is between 5% and 10%.*

Umbrella/excess liability insurance

Much like GL, umbrella/excess liability policy increases are also expected to moderate relative to the higher double-digit increase of the past two years. While still volatile, the pace of increases is moderating as the impact of historical rate increases flows through.

However, social inflation, runaway juries and mass torts remain a concern as courts in the US begin working through the backlog of lawsuits filed during the COVID-19 pandemic. Given continued volatility, the current rate increase benchmark is between 5% and 15%.*

Workers' compensation insurance

Workers' compensation remains the least challenged line of business from a rate perspective and remains a competitive market. While the line of business remains profitable for the industry, climbing medical costs and other macroeconomic factors could put pressure on rates in 2023. The current rate increase benchmark is between -5% and +5%.*

*Subject to actual client geography, exposures, deductibles and losses.

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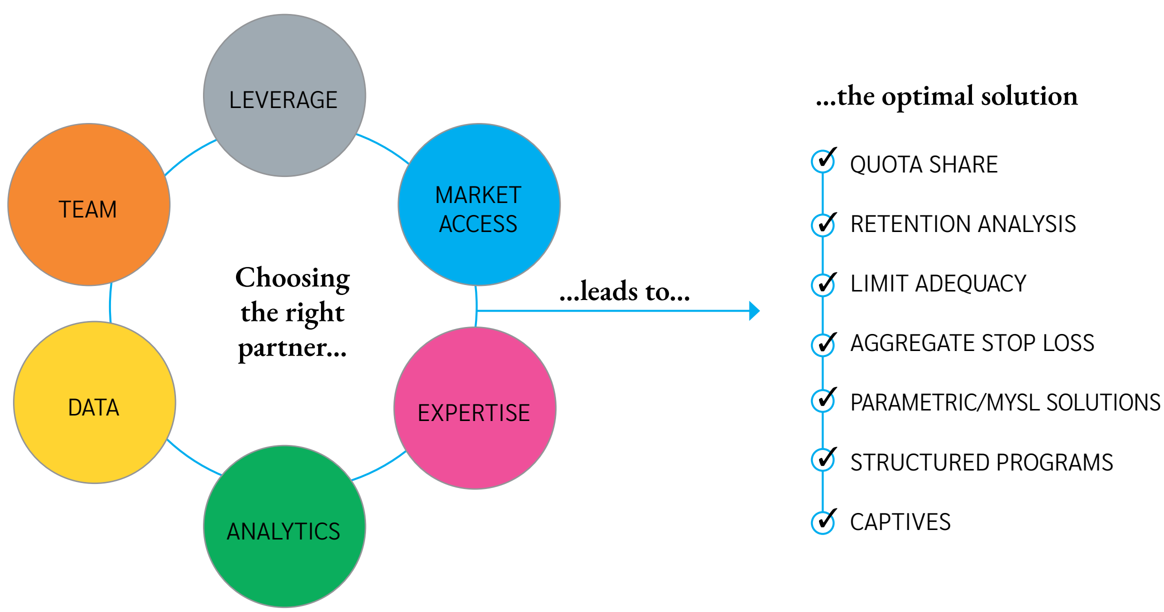
Best practices for real estate insurance buyers

1. **FOCUS ON SUBMISSION QUALITY.** Failing to provide detailed submissions could result in less favorable outcomes or insurers walking away from negotiations. Work with your broker to ensure your submission has complete, accurate data. This is especially important for your statement of values (SOV), which should include updated valuations for all properties. Also highlight any loss prevention measures or code upgrades you have introduced to mitigate risk.
2. **EVALUATE YOUR RISK TOLERANCE.** Volatility must reside somewhere, and insurers increasingly expect that a portion of it will be on insureds' balance sheets rather than their own. Expect insurers to push for or even demand that insurance buyers retain more risk via higher deductibles. The use of modeling and analytics is critical to finding the right balance between risk retention and premium.
3. **ENTER RENEWAL NEGOTIATIONS WITH A CLEAR STRATEGY.** Set specific, realistic goals before meeting with underwriters. Be prepared to address their concerns while evaluating options for premium offsets through structure changes, deductible changes, and/or use of other alternative strategies, such as parametrics, structured programs, and multiyear single-limit options for catastrophic perils.
4. **YOUR BROKER MATTERS MORE THAN EVER.** Your choice of insurance advisor can be the difference between a positive outcome and a disastrous one. The right partner can provide a team of brokers with real estate-specific knowledge and experience, who can act in lieu of or as an extension of your own risk management team. They can also offer strong underwriting relationships, market access and the ability to help you anticipate insurers' questions and respond to them. And they can help your submission stand out through data and analytics that are becoming increasingly important to underwriting decisions.



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