MAY 2023

State of the Market
Real Estate Insurance

BRP
REAL ESTATE PRACTICE

OVERVIEW

The BRP Real Estate Practice anticipates the challenging market conditions of 2022 and the first quarter of 2023 to continue for the remainder of the year due to several reasons, including:

WEATHER EVENTS
The steady occurrence of severe weather and natural disaster events nationwide such as flooding, wildfires, and windstorms.

PROPERTY VALUATIONS
An increased emphasis by carriers on property owners and operators to utilize accurate replacement cost valuations.

MARKET CAPACITY
A decreased appetite among carriers for certain asset types and geographies.

RISING COSTS
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The cost of nearly everything continuing to rise; it is hard to dismiss the inevitable impact of inflation on the insurance industry. From construction materials to labor and services, the impact is difficult to quantify but is irrefutable.

This article explores these factors and others, as well as highlights actions owners and operators can take to position their portfolio's renewal submission and overall risk management strategy for the best outcome — this year and moving forward.

Perhaps an appropriate opening is the consideration that no real estate owner or portfolio is immune to the challenges of the current insurance marketplace. Taking all that has occurred globally in recent years into consideration — the pandemic, numerous catastrophic weather events, national and international political unrest and war, an uncertain economy with rising interest rates and supply chain issues, and more — the impact to the insurance market is unprecedented.

Insureds must acknowledge the larger backdrop and recognize that every portfolio is unique. The current rates or renewal results of one portfolio should not be hastily compared to another. While two portfolios may seem comparable, rates and renewals are affected by numerous contributing factors such as asset type, geography, portfolio size, asset valuation, loss/claim history, deductible structure, and risk mitigation and risk management implementation.

Those that will face the greatest challenges are wood-frame habitational assets and properties located in areas of increased risk for catastrophic (CAT) weather and natural disaster events. However, all property owners should enter their renewals aware of present market conditions.

All portfolios should be braced for the possibility of rate increases, deductible increases, valuation corrections, capacity cutbacks and/or limitations, as well as coverage restrictions — or some combination thereof.

BRP can help you identify and evaluate options to find the best insurance and risk management solutions for your real estate portfolio.

PROPERTY INSURANCE

No strong evidence exists that the increasing commercial property rates experienced throughout 2022 and Q1 2023 are stopping. However, a wide range in renewal results occur due to a host of contributing factors — many of which are interrelated — all of which are important for real estate owners to comprehend. Some factors such as inflation or supply chain issues may be shorter lived. For other factors, the likelihood of impact being shorter lived seems implausible, such as the rising occurrence of severe weather events, which are impossible to predict or control. In aggregate, the totality of these factors and others will drive rate for the foreseeable future.

Weather and climate-related events

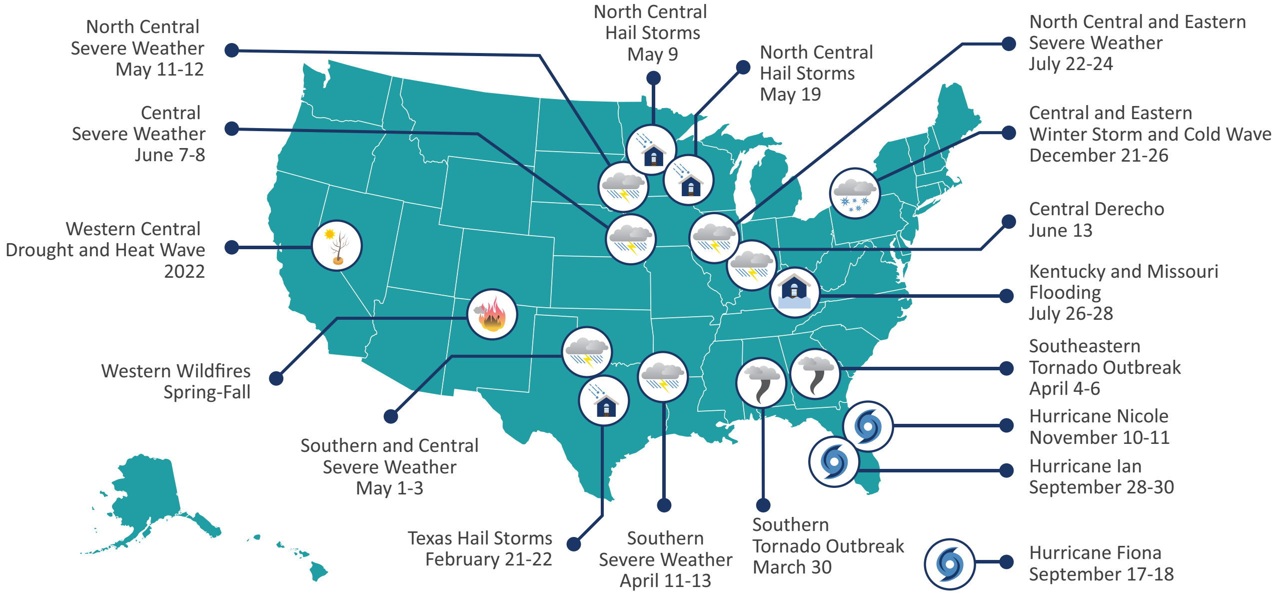
Highly destructive weather and climate-related events — such as hurricanes, floods, tornados, and wildfires — are a regular occurrence in the United States. The increase in severe weather events and their ensuing insurable losses have lessened carriers' appetite for risks in CAT-prone areas. According to the March 2023 U.S. Property Insurance Review published by national insurance wholesaler RT Specialty, 18 weather or climate-related events happened in 2022 in the U.S. with losses exceeding $1 billion each, with estimated losses totaling over $170 billion.[1] For context, according to the National Centers for Environmental Information, 348 such weather or climate events have happened since 1980, and the annual occurrence average continues to increase. In the past 42 years, there was an average of 7.9 annual events occurring from 1980-2022. However, when you look at the average by decade, the trend is clearer: an average of 3.3 events per year in the 80s, an average of 5.7 events per year in the 90s, 6.7 events per year in 2000-2009, and 13.1 events per year from 2010-2019.[2]

Hurricane Ian, which made landfall on September 28, 2022 in Ft. Myers, Florida, is presently the third (3rd) costliest storm to impact the U.S. on record, with estimated insurable losses approaching $65 billion — the total amount of which will be determined as further claims are closed.[1]

While a large hurricane may receive widespread media attention, many smaller events do not; the public may not realize the extent which these too have driven substantial insurable losses on the books of insurers. For example, hail damage resulted in $16.5 billion in claims in 2021, up 16 percent or $14.2 billion in 2020. Hail damage has spread to more states in recent years, with more than 6.8 million U.S. properties damaged by hail in 2021.[3] Apart from Texas, the top five states for major hail events in 2022 — Nebraska, Minnesota, Kansas, and South Dakota — have no direct exposure to coastal storms. Many real estate owners of properties in these geographic regions may not realize the lens through which carriers view (and therefore charge) their exposure from a CAT perspective.[4]

Due to these events, insurers have paid out more in claims than they have collected in premiums in recent years. These payouts were incommensurate with collected premiums both because of the frequency and severity of events and because the cost of repairs exceeded reported replacement costs. Now, carriers are correcting pricing after real estate owners benefited from many soft market years.

U.S. 2022 Billion-Dollar Weather and Climate Disasters



This map denotes the approximate location for each of the 18 separate billion-dollar weather and climate disasters that impacted the United States in 2022.

Source: https://www.ncei.noaa.gov/access/billions/

Building valuation

You may be having the valuation conversation with your insurance broker or carrier partners presently — if not, it should be on your radar. During softer market years, many property insurers did not emphasize the importance of updated and/or accurate property replacement costs. What has resulted is many property portfolios are underinsured on a cost-per-square-foot basis — i.e., lower than the actual cost to rebuild or repair following a loss. A study conducted by McKinsey revealed that in 2022, there was a $32 billion increase in how much insurers paid over initial expectations.[5] In the Q1 2023 state of the market report issued by national insurance wholesaler Amwins, it was suggested that carriers believe insurance-to-value (ITV) for real estate property portfolios is off by 30 percent or more.[6]

Property owners have benefited from this in softer markets. Property premium is a simple math equation; a rate is applied to every $100 in total insurable value. As such, a lower property valuation results in lower property premium due to the lower premium basis. In today's market, carriers are increasingly requiring property owners to utilize correct replacement costs or be forced to accept coverage restrictions such as "scheduled values" or "margin" clauses versus the preferred and stronger replacement cost coverage.

Rising costs & inflation

But why the increase? For one thing, cost of construction has increased — from labor and material, project delays, and more.

Following claims insurers have experienced higher than expected costs because rebuilding and loss remediation often exceeds the total insurable value of the asset initially reported to and underwritten by the carrier.

What's more, during periods of rebuild and repair, there is often an additional component to the claim regarding business interruption or loss of revenue. Carriers are increasing their focus correcting assets' replacement cost and the accurate reporting of business income figures, accordingly.

In a recent piece, *The Wall Street Journal* discussed the effect of inflation and rising construction costs. While consumer costs, as measured by the consumer-price index, went up 6.4 percent in January over the same costs in 2022, various construction-related costs have increased more than that figure. In addition to actual materials costing more, labor costs themselves are even higher.

As one example, roofing and glass materials are up 12-13 percent year over year, while the cost of roofing workers is up 21 percent.[5]

Property during construction

From a construction standpoint, property insurance during an asset's construction — or builder's risk insurance — is equally impacted. Those projects in CAT-exposed regions and/or constructed from wood-frame are the most effected. Carriers are focused on site safety and risk mitigation technologies more than ever.

An additional complication of the current marketplace is a project owner's or developer's ability to obtain policy extensions is notably more challenging compared to previous years. Carriers are either unwilling or unable to provide them. If achieved, carriers are often charging an extension rate significantly higher than the binding rate. For newly constructed assets, expect property carriers to inquire heavily as assets transition from builder's risk to completed property insurance — what work remains, if there is a formal Certificate of Occupancy (CoO), and what fire and water losses occurred during the construction term — to name a few.

Key property takeaways

The list of factors that impact the hardened property market is long, but fundamentally, insurers cannot be in the business of paying out more money in annual claims proceeds than they collect in annual policy premiums. High losses in recent years — far exceeding historical averages — and further unpredictability surrounding our nation's weather patterns have made carriers more risk-averse. Reduced carrier capacity and in some cases markets leaving a space altogether based on geography and asset class are other factors.

Reinsurers — or the insurance companies providing financial protection to insurance companies — must be considered as well, as a domino effect has occurred. Reinsurers have responded by substantially increasing treaty rates, which impacts the underlying insurance company's premiums to the buyer. According to McKinsey's 2023 Global Insurance Report, property insurance CAT reinsurance rates increased by 37 percent in January's treaty renewals — the highest increase reported since 1992.[7]

It is important for buyers of CAT-driven property exposures to understand that reinsurance is a major component of an insurance company's ability to take on (or insure) their risk. The reinsurance market sits on a global stage and is affected by domestic and worldwide events. Examples of 2022 events include the ongoing pandemic; North American wildfires; Hurricane Ian; the Russo-Ukrainian War; and significant earthquakes in Papua New Guinea, Afghanistan, and Mexico. In addition, rising interest rates in 2022 cut the value of reinsurers' bond-heavy investment portfolios, leading to unrealized losses and depleting shareholders' equity. Rising interest rates also depleted the alternative CAT bond market as investors sought safer havens. The net effect: reinsurance capital supply is currently estimated to sit down $50 billion year-over-year, while demand is estimated to currently sit up $30 billion. Said plainly, supply is less and prices are higher for the end user.

In summation, the influences are abundant and certainly interrelated; inflation, geopolitical risk and uncertainty (including but not limited to the Russo-Ukrainian War), rising costs of construction, labor shortages, ongoing supply chain delays, the lingering global effect of COVID-19, and overall unpredictability of what lies ahead are all noteworthy contributors.

LIABILITY INSURANCE

The real estate liability — often referred to as casualty — insurance market is not without its own challenges, but we will commence with the good news. At the risk of being overly broad, real estate owners with low loss records and or low habitational exposure can expect favorable renewal rates — flat or low single digit increases, particularly on the primary layer. The outlook is significantly different for higher-risk or crime jurisdictions, as well as those portfolios with hotels or residential units such as garden-style, student, senior, or governmental assisted units. Those real estate owners or operators in harder-to-insure asset classes and geographies should prepare for higher rate increases, higher deductibles and retentions, and greater coverage restrictions.

Excess or umbrella liability remains slightly more difficult, albeit performing better than in recent years. Carriers providing lead excess capacity are still being cautious about how much and where to deploy capital. Programs that historically led with a primary $25 million in excess are increasingly uncommon, with more carriers needed to build up coverage limits.

Available capacity in the liability market is less of a concern than with property insurance, with new capacity entering the market in recent years.

Similar to the property market, the reason for increased costs and challenges in the liability space is multifactorial.

Some factors include:

Crime

Poor crime scores are having a significant impact on underwriting, with some carriers restricting or excluding assault and battery (A&B) and sexual molestation coverage.

Habitational Settlements

The incidence and dollar amount of habitational claims against real estate owners have increased in recent years, with lawsuits resulting in $1 million-plus awards or settlements. These suits are often allegations of a property not meeting habitation standards due to water leaks, HVAC or electrical failures, defective sewage, insect and vermin infestations, and other factors.

Nuclear Verdicts and Social Inflation

Nuclear verdicts — high-dollar awards from juries — have resulted in substantial carrier losses. Social inflation also results in higher claims costs. These factors both contribute to liability insurance rate increases.

MARKET WIDE OBSTACLES

A hard insurance market does not only mean increasing rates. The below details additional issues real estate owners and operators should be prepared to face across both property and casualty insurance renewals.

Higher Deductibles and Retentions

Portfolios with residential and wood-frame construction should expect higher insurance attachment points particularly for all-risk and water damage deductibles. An increasing number of states beyond the routinely considered Florida are seeing higher wind and hail deductibles imposed. On general liability policies, it is not uncommon to have per-occurrence deductible versus the long seen first dollar coverage. Take care to review your loan agreement as deductibles may need to be discussed and negotiated.

Lower Sublimits

Owners may find that their sublimits may change over a previous year's renewal program. Carriers are sometimes imposing lower sublimits on certain types of losses, when in previous years higher or "included" limits may have been readily achievable.

Renewal Time Crunch

The volume of renewal submissions, insurance industry staffing shortages, coupled with a rapidly evolving and everchanging insurance landscape have resulted in renewal quotes being issued closer to the time of policy renewal, leaving owners and managers little time to consider options.

CALL TO ACTION: HOW TO NAVIGATE A CHALLENGING MARKETPLACE

The hard — or what owners more likely call expensive — market is not news to most real estate owners, managers, and developers. What is perhaps more relevant is the following question: "What can we do to better position ourselves for the best renewal outcome?"

Put concisely, the answer is: those who incorporate the best operational, safety, and financial controls will achieve the best outcomes. In national wholesaler RT Specialty's Q1 property insurance review, a similar sentiment was shared: "Accounts which have performed well from a loss perspective and insureds committed to risk management improvements, are able to obtain more favorable renewal outcomes, albeit still with rate increased."[1]

While some actions will require capital expenditures, these will almost certainly deliver a return on investment. While that ROI is difficult to quantify, the below are actionable items that will strengthen your risk profile and should be discussed with your insurance broker and carrier partners. It is important to note that depending on your asset class, some carriers may require these additional risk management protocols and preventative measures as a condition of their capacity.

Property management

Crime Prevention

Enhanced security protocols and strengthening security systems should be a priority, particularly for assets with a poor crime score. Examples include improving lighting, upgrading locks, and installing security cameras.

Roof and HVAC Maintenance

Implement regular roof and HVAC maintenance programs, especially for office buildings and industrial assets as well as across older properties. In winter prone climates, a specific snow and ice removal plan with written and executed agreements is advised.

Freeze Mitigation

Implement procedures to mitigate the likelihood of water loss due to freezing temperatures. Carriers often require a minimum building temperature of 40 degrees Fahrenheit. Equipment and materials should be in place to prevent damage, including sufficient insulation and backup power, with available building personnel 24/7, particularly during and immediately after weather events.

Solar Panel Management

Contract with a structural engineer to ensure that panels are placed properly and that the weight load is safe. While roof-mounted photovoltaic (PC) panels offer many benefits and are increasingly common, their presence does not come without risk that needs to be managed prudently.

Improved Contract Agreements

Third-party vendor contract agreements are more important than ever. From property management, snow removal, security providers, to subcontractors, carriers want to increasingly understand who your providers are, and what their contracts include from an insurance requirement, indemnification, and risk transfer perspective. Even when these parties maintain proper insurance, it is not likely for their insurance to respond correctly without a properly written contract agreement.

CAT Preparedness Measures

Carriers will inquire about risk mitigation and preparedness measures for the type of events applicable to your geography.

Whether your asset or portfolio is prone to hurricane, tornado, wildfire, or flood risk, preparedness is essential.

Knowledge management

In addition to actions at the property level, addressing the following will better position your knowledge and bank account going into renewal. No property or portfolio owner should be subject to surprises at the eleventh hour regarding rate or premium increases or restricted terms, limits, or policy conditions.

Conduct Premarketing Inspections

You can improve the visibility of your risk control operations by completing comprehensive premarketing inspections of all major building systems. Consider reaching out to BRP's Risk Mitigation Service Team to discuss our inspection process and options. This may also shed light on possible areas of concern; you can address issues prior to renewal negotiations.

Budget Comprehensively

Poorly done insurance budgeting can adversely affect a property owner's balance sheet, impact financing, and result in unpreparedness for premium payment. Your broker partner should create an accurate insurance budget each year – both conservative and aggressive target pricing. As market conditions and or your portfolio changes, the budget should be revisited and revised accordingly. Large national events or changes to your CAT footprint or loss activity could meaningfully impact your insurance cost projection.

Regular Communication

It is never too early to discuss renewal strategy with your broker partner; at minimum, you should be prepared to leave 90 days or more for the carriers to work on your submission. The larger or more at-risk your portfolio, the more time the market will need. While carriers are routinely issuing renewal quotes close to the renewal date, it behooves the insured and their broker to be in regular communication with each other for the months leading up to your renewal date to discuss the market conditions, renewal strategy, budgeting, and more.

Submission recommendations

COPE Document

Construction Occupancy Protection Engineering (COPE) documents should be as robust as possible. Gone are the days of carriers simply accepting addresses and TIVs to present quotes. Those submissions with the most specific and accurate data receive more underwriting attention and achieve better cost and coverage results. We encourage you to report data on all aspects of each asset, including but not limited to: (sub)basement and roof information, year built, HVAC and equipment detail, sprinkler type and other fire protection, renovation/improvement years and particulars, property management partnerships, building security information, wiring type, flood mitigation, and location of mechanicals.

Modeling Data

While carriers will perform their own modeling, broker modeling can add additional context and data, and potentially prevent carriers from assigning higher risk and prices to your portfolio than warranted. It is important to understand your Probable Maximum Loss (PML), your Average Annual Loss (AAL) expectancy, any assets that are expected loss leaders, and your 250-500 year CAT modeling results. BRP can help develop comprehensive risk modeling information for your portfolio using EigenRisk's modeling platform to better inform your purchasing decisions.

Coverage options

Your broker partner should be evaluating and discussing the range of coverage options and financial tools available. The best time to educate yourself is outside the renewal crunch time. Procuring numerous renewal options can take time – it is never too soon to begin the conversation.

Deductible Structures

Increasing your deductible — insurance attachment point — can be a meaningful tool to take on slightly more risk, thereby offering some premium relief. Options may also include a deductible indemnity agreement.

Parametric Policies

This type of policy — with coverage triggered by a specific condition, such as wind speed or earthquake magnitude — can help contain costs and offer meaningful protection for large or doomsday CAT events.

Lender Negotiation

Educating lenders with detailed asset information and current risk assessment modeling may help achieve insurance requirement concessions by your debt provider. Appropriate areas of discussion include CAT limits, deductibles, and umbrella limits. The goal should be to bring their insurance requirements in line with the current marketplace and the unique exposure of each portfolio.

OPPORTUNITY

BRP will continue to monitor the rapid market evolution. According to PwC's Annual Global CEO Survey, insurance industry executives agree that change is inevitable. Insurance company CEOs feel exposed to a myriad of issues including inflation, economic volitivity, cyber risk, geopolitical risk, and climate change. What's more is evolving customer preferences, technology, and regulation will further impact the industry. However, a climate of unpredictability and obstacles brings huge opportunity for solutions.[8]

In its 2023 Global Outlook Report, EY focuses on how carriers will be forced to think beyond their present offerings and procedures. An additional factor is presented — the changing face of the insurance customer base. As Gen Z and Millennials continue to rise within the workforce, insurers must engage and operate accordingly. Actuarial innovations, customized products, advanced service models for evolving classes of risk such as the metaverse, as well as the co-creation of insurance products beyond insurance companies involving other financial institutions and tech platforms will be a necessity.[9]

No one has a crystal ball. It is impossible to know where the insurance market will be a year or two from now, but your broker partner should be poised to navigate the uncertain climate with you. From education on present and evolving conditions, knowledge regarding new solutions and more, your broker partner should arm you with facts and tools that will create better business decisions.

Reach out to your local commercial risk advisor to discuss the current marketplace and strategies for your real estate portfolio's insurance and risk program.

With specialized expertise and resources, our team can help evaluate your current coverage, review your portfolio, and find the best path forward for all things insurance and risk management in today's challenging landscape.

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1 RT Specialty, "U.S. Property Insurance Review," March 2023.

2 NOAA National Centers for Environmental Information (NCEI), U.S. Billion-Dollar Weather and Climate Disasters (2023).

3 Verisk, "Understanding Evolving Hail Risk."

4 Insurance Information Institute, Facts + Statistics: Hail. 5 The Wall Street Journal, "Inflation Means Businesses Face Insurance Woes When Rebuilding."

6 Amwins, Q1 State of the Market.

7 McKinsey, "Global Insurance Report 2023: Expanding Commercial P&C's Market Relevance."

8 PwC, Annual Global CEO Survey 2023: Insurance Industry Highlights.

9 EY, 2023 Global Insurance Outlook.