Gallagher

Insurance | Risk Management | Consulting

Spring 2020 Real Estate & Hospitality Insurance Market Update

Where Do We Begin?

In the first quarter of 2019, the commercial property and liability insurance market was beginning to see premium increases and reduced capacity in response to multiple years of catastrophic losses in both sectors. Hurricanes Harvey, Irma, Maria, Michael, Florence and a continuing pattern of convective storm losses brought combined property loss ratios up to the high 90–105% range. To make matters worse, two high-profile property claims hit the market in which the values reported were a fraction of the actual losses sustained. This situation severely impacted the carriers, who realistically thought they were attaching excess of a specific location. This caused the excess property market to not only reduce capacity, but, in many cases, raise premiums at a higher rate than the primary markets. On a positive note, there was investment income from a robust stock market, but this was shortly followed by the outbreak of the current global pandemic.

Impact of COVID-19 on Insurers

It is almost impossible for anyone to say with certainty that they can accurately predict how insurers will respond to what could be more than $300 billion of monthly business interruption income losses. As of the date of this writing, federal legislation has been introduced requiring insurance companies to cover business interruption losses due to the pandemic, forced closure of businesses and mandatory evacuations. Numerous states have introduced similar legislation. Additionally, California has issued requirements for premium rebates, but the practical result remains to bee seen and how carriers will react. There is no dearth of law firms offering their advice, and services, and one thing that appears certain at this point is that in the absence of a "back stop" implemented by the federal government, there will be years of litigation to resolve these issues.

What has transpired in the past few weeks is reminiscent of the insurance market post-9/11, when some office buildings paid more than $1 million for terrorism coverage. Property carriers have reacted swiftly, introducing policy language focused on restrictions (additional and new) on pandemics, virus, microbial, ingress and egress, civil authority and business interruption/extra expense, and increasing deductibles and retentions. These changes have varying degrees of impact depending on the asset class, and the hospitality industry may be the most dramatically impacted due to the direct losses from cancelled reservations. Sadly, even prior to COVID-19, multifamily and hospitality risks were facing the highest property rate increases due to the frequency of fire and water damage claims. When coupled with the increasing number of convective storm losses across the Midwest, South, Southeast, Texas and Colorado, this has made these asset classes less desirable from an underwriter's point of view.

What are the five key factors that underwriters take into consideration?

From a micro to a macro view, underwriters look at the following:

1. Asset classes
2. Geography
3. Clients' 5–7 year loss history
4. Overall market conditions
5. Underwriter's own exposure to catastrophic risk

What are the Average Rate Increases for Property Risks?

This is a daily question and is a function of the five factors listed above. Since the beginning of the year, we have seen the following rate changes, all of which assume that an organization and its assets have **less than a 45%** combined loss ratio over the past five years. This chart shows that portfolios with 30% or more of multifamily dwellings, higher loss ratios, a large percentage of assets exposed to convective storm or flood, or those purchasing more than $100 million of California Earthquake or $250 million of Tier 1 wind may have seen greater increases.

Asset Class	Rate Increase**
Mixed Portfolios	15–25%
Multifamily (shared, layered and catastrophe-exposed, including convective storm)	20–30%
Hospitality	25–35%
Commercial Office* (shared, layered and catastrophe-exposed)	18–30%
Retail	20–35%
Industrial Flex	12–25%
Single Family Homes (SFH)	8–20%

*There are exceptions, particularly with some regional carriers that are focused on smaller portfolios. In this case, rate increases can be less than 10%.

**Ranges will vary based on catastrophe limits purchased, geography, age of assets, expiring rates and other individuating factors.

We are aware of global hospitality programs which renewed at rate increases well in excess of 50%, and with lower limits and higher deductibles than in previous years.

Speaking of deductibles, they are also under pressure, with most carriers pushing hard to increase them for water damage, convective storms (i.e. hail, tornado) and, in the case of multifamily, "all other perils." Attritional losses have made many insurers re-evaluate not just the deductibles, but the amount of capacity that they are committing to insureds. To that end, we have seen an industry-wide migration toward reduced limits. An additional wrinkle to understand is "split deductibles", e.g. when multiple carriers on a primary layer each have different deductible requirements, resulting in a "blended" deductible that is calculated on the percentage participation of each insurer. This may sound complicated, but split deductibles have been in place for at least two years and actually protect the insured from taking the highest deductibles across all of the carriers.

The General Liability and Umbrella Markets

Real estate and hospitality are particularly exposed to commercial general liability claims due to the 24/7 exposures in multifamily, hospitality and SFR's. Sadly, retail owners have more than "slip and falls" to consider given the increase in active shooter exposures. Plus, commercial office owners in New York and other major metropolitan cities are seeing claims from contractors' employees alleging owner negligence in what would have normally been a simple workers' compensation claim. Industrial flex is the only asset class that is seeing "stability" at this stage, and we are all learning about social inflation, the Plaintiff's Bar's use of Reptilian Theory (visceral/fear based) and how economic despair is driving general liability claims and expenses. The response from the umbrella markets has been to cut capacity and increase premiums for hospitality and multifamily insureds by as much as 20-30%.

Additional key factors include:

- Rising concern in workers' compensation due to the opioid crisis.
- Rising sexual abuse claims amid the #MeToo movement, coupled with judicial law changes such as the child Fair Labor Standards Act.
- Increased active shooter and general standalone terrorism incidents.
- Increased auto claims, in both frequency and severity, due to decreased oil prices, increased cellphone and marijuana use while driving and an increase in overall tech advancement of vehicles.
- Increases in both frequency and severity of wildfires leading to liability payouts by insurers.
- Increase in carelessness of construction workers leading to construction liability losses.
- Expansion of concept of liability and overall settlements/ judgment decisions by judges and juries going after "deep pockets" of large companies.

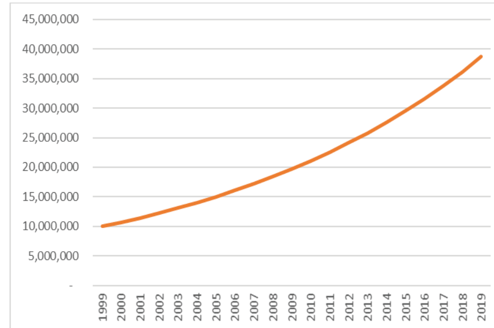
Examples of Headline Claims:

- Active Shooter, Hospitality — $800 million settlement (late 2017).
- Class action lawsuit — Product liability — $2 billion-$10 million settlement–Late 2018.
- Product Liability/Completed Scenarios — $143 million settlement (late 2019).
- Active shooter, Retail — $70 million settlement (mid-2019).
- Class Action Lawsuit, Product Liability — ~$4.69 billion verdict (mid-2019, Nationwide).
- Sexual Assault Victim, Real Estate — $1 billion awarded (mid-2018).

The resulting impact on the umbrella market:

- 1999 — Claim settles for $10 million.
- 2009 — Same claim would settle for $19.7 million (assuming 7% trend).
- 2019 — Same claim would settle for $38.7 million (assuming 7% trend).

Sources include: Chubb Excess Casualty Market Update



What does this mean from a General Liability and Umbrella* rate perspective for organizations with seven year loss ratios below 40%?

Asset Class	Rate Increase
Mixed Portfolios	5–10%
Multifamily*	15–30%
Hospitality*	10–20%
Commercial Office **	5–20%
Retail	15–25%
Industrial Flex	5–15%
SFR (Single Family Homes)	10–20%

*Umbrellas for multifamily and hospitality are substantially higher due to significant reductions in capacity and 24/7 exposures.

**High rise assets also experiencing reductions in umbrella limits due to changes in certain programs (Distinguished, Aura, Preferred, et al.).

Risk Management and Preparing for the Coming Quarters:

- Organizations must pay close attention to their rental income projections and the hospitality industry should reforecast on a monthly basis.
- Valuations are being scrutinized, with many carriers running their own analysis regardless of the values being submitted. "Hide the Hat" valuations are a thing of the past.
- Improve protocols and communicate to underwriters all life-safety measures being taken in anticipation of assets reopening and in the ongoing operations of assets.
- Discuss with lenders the need to revisit 100% S&P ratings for securitized placements. There are numerous A.M. Best AXIII-XV carriers that don't have S&P ratings and by utilizing them, pricing can be tempered.
- Consider retaining higher deductibles to offset insurance sunk costs.
- Investigate the development of Captive Insurance Vehicles for long-term self-funding, particularly of deductibles.
- Provide detailed secondary characteristics in property submissions.
- Get to know your underwriters and develop a profile that distinguishes your organization from others.
- Start the renewal process early.

Conclusion

We all recognize that owners, managers, investors and every other stakeholder is feeling pain from this crisis. It is important to keep in mind that while insurance may be a commodity-based market, it still relies on human relationships when it comes to developing long-term and sustainable property and casualty programs.

Gallagher

The Gallagher Way.
Since 1927.

ajg.com