Spring 2024 Real Estate and Hospitality Market Update

Gallagher

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Introduction

It's About Time!

2024 has kicked off with an improved property market based on the lack of material hurricane activity in 2023. In recent meetings in London as well as domestically, the common theme is that the property markets want to grow and retain clients. This is translating into lower pricing increases compared to previous years, though, as you will note in the following little changes in terms and conditions.

There is chop in the casualty waters, but professional liability continues to stabilize. We welcome your thoughts and comments.

PROPERTY

High-tide property market conditions are beginning to recede as modest injections of fresh capital re-enter the marketplace. Challenges remain, but the hurdles to clearing the renewal process are much lower than in years past.

Valuation

The pace of mandated value increases has slowed compared to previous cycles. For insureds who have achieved valuation adequacy in the eyes of insurers, renewal value increases are falling in line with US headline inflation, which at the time of writing stands at +3.2%. However, those lagging behind may face mandated increases of +10% to +20% to bridge the gap.

Deductibles

There's been little to no rate concession for policyholders, despite insurers mandating higher deductibles. Water damage deductibles in excess of $100,000 are here to stay for mid- to high-rise buildings. We have seen carriers seeking $250,000 and above, pushing insureds to retain frequency losses for water damage and reserve coverage for severity issues. All other peril (AOP) deductibles are on the rise as well. Where select super regional insurers were once comfortable offering $5000, we are now see a $10,000 floor.

PROPERTY

Rate

The rate increases we have observed vary by loss performance and exposure to various perils. We expect that non-CAT exposed, well performing risks will see renewal rate increases in the range of flat to +10% for most asset classes. Habitational risks remain the most challenged pocket of the market, and rate increases will likely fall between +5% and +15%. Insureds with exposure to catastrophic risk or bad loss experience can expect a continuation of rate increases in excess of +15%.

Terms and Conditions

During our renewal negotiations, we have observed a resurgence of insurers offering blanket limits, often leveraged against demands for true and accurate replacement cost values. For shared and layered placements with perceived valuation issues, margin clauses and scheduled limits remain prevalent terms and conditions.

Capacity

Capacity is an evolving landscape, with a limited number of new entrants favoring smaller portfolios with single-location TIVs up to $20 million. Underwriters have demonstrated flexibility and a collaborative approach during renewal negotiations. Larger risks that require shared and layered placements will benefit from a revival of capacity in the London marketplace. This increased competition has resulted in downward pricing pressure placed on North American insurers. As a result, increases have moderated and in some cases decreases can be achieved. However, securing large amounts of capacity remains a challenge for risks with heavy CAT exposure to perils such as earthquakes and named storms. Finally, large, dense, wood-frame multifamily assets create challenges for insurers when securing their reinsurance. This adds frictional costs for single-location risks with values in excess of $50 million.

Builder's Risk

In the builder's risk market, rates continue to escalate, especially for wood-frame projects. Water damage deductibles remain elevated. Insureds should expect to encounter stringent underwriting conditions such as site security, proximity to fire hydrants, fire-suppressive treated wood, and more in order to secure pricing.

CASUALTY

Without meaningful changes in tort reform and jury disclosures related to third-party litigation financing (TPLF), claims costs will continue to balloon, taking rates with them. TPLF is among the greatest threats to the sustainability of the casualty underwriting ecosystem. One reinsurer even added more than $2 billion worth of funds to their reserves for claims related to US casualty placements in 2023 alone.[2]

Rates

At the time of writing, average rate increases for primary general liability policies are falling between +3% to +9%, according to Susan Patelson, National Casualty Leader for Gallagher's Real Estate and Hospitality Practice. Insureds are struggling the most with larger placements that require a lead $25 million umbrella. This layer of liability cover is where insurers are seeking the most rate because they feel the most exposed to nuclear verdicts (verdicts in excess of $10 million) fueled by TPLF. This is especially true for insurers attaching excess of a $1 million primary.

Capacity

Carriers are reducing the capacity they are willing to offer. This increases the number of insurers required to fill out large liability, towers and adds frictional costs via minimum premiums.

Terms and Conditions

In multiple regions around the US, we are seeing carriers restrict coverage enhancements like uncapped policy aggregates. This poses significant challenges for those with stringent lender requirements. Underwriters continue to push for exclusions related to abuse and molestation, assault and battery, habitability and firearms.

Renewal Strategy

In a dynamic casualty marketplace, more favorable renewals can be secured via broad and comprehensive marketing exercises. Additionally, organizations that can demonstrate risk mitigation through on-premises property management and strong contractual risk transfer will be viewed favorably by underwriters. Insured planning renewal strategies should seek to offset price increases in the primary layers by leveraging insurer competition in layers excess of $25 million.

The Danger TPLF Presents to Policyholders[1]

Insurers were among a group of 25 major corporations that sent a letter to the US House of Representatives Committee on Oversight and Accountability last October:

- Our federal courts are being overwhelmed by mass tort cases, as upwards of 70% of all civil actions pending nationwide in the federal system are such mass tort lawsuits.
- Lawyers pitch their tort theory to third-party litigation funders, who furnish cash in exchange for a share of the promised extraordinary yields. In turn, that cash is used to launch massive advertising campaigns to recruit many thousands of people to file lawsuits alleging injury by the targeted product.
- They know that the costs, burdens, and disruptions caused by the sheer volume of claims will force many defendants to settle, even if the merits do not favor plaintiffs.
- A recent study by the Institute for Legal Reform found that for every dollar paid in damages through tort litigation, only 53 cents actually reach the claimants' pockets.

MANAGEMENT LIABILITY

Management liability premiums remain stable overall, with some experiencing slight decreases.

Directors and Officers Liability

Emily Loupee, Management Liability Co-Leader for Gallagher Real Estate & Hospitality Practice, has seen more than 30 new insurers added during the past 3 years. The increased competition has continued to drive down rates. Underwriters seeking rates have been pointing to increases in loss severity as a result of social inflation. Insureds with portfolios dominated by commercial offices will also see pressure on rates as this asset class continues to face challenges in the post-COVID era.

Cyber Liability

Following broad rate reductions in 2022, most cyber renewals are coming in near flat as claim frequency picks up. The most common loss drivers are the use of AI by bad actors to increase their attempts at social engineering and phishing attacks. Ransomware is also a front-runner for claims in the cyber arena. Many insurers believe rates could start to increase later in 2024 in response to losses. A study commissioned by Apple and conducted by the Massachusetts Institute of Technology revealed that data breaches increased by 20% in 2023 relative to 2022. The study also found that 98% of organizations have a relationship with at least one technology vendor that experienced a data breach in the previous two years.[3]

Employment Practices Liability

Employment Practices Liability faces pressure on deductibles, especially in high-risk states like California, Texas, and Florida. The saturated D&O market created tailwinds for EPL as D&O insurers sought to position themselves on larger EPL placements to replace declining D&O premiums.

ESG

The US Securities and Exchange Commission recently implemented new regulations mandating certain requirements for climate-related disclosures for US public companies. These new regulations require companies to disclose information related to climate risks facing their business that have had or are reasonably likely to have a material impact on the organization. Companies are further required to outline plans to mitigate these risks and their resulting financial impact. This information is a reporting requirement for their registration statements and annual reports.

While many companies already disclose some amount of climate-related information, the SEC asserts that the new rule will enhance consistency and standardization, thereby improving reliability and comparability. The adopted rule requires the disclosure of Scope 1 and Scope 2 emissions, when material to an organization. Several states and business organizations have challenged the regulations through litigation and legislation.

These new regulations are particularly significant for the real estate and hospitality sectors, as many organizations are actively investing in improving energy efficiency and integrating sustainable practices into their construction and asset management operations.

REINSURANCE

In reinsurance, property supply and demand have balanced, as returns have exceeded reinsurers' increased cost of capital. Specialty line capacity remains buoyant, as coverage is the primary concern rather than pricing. Overall, 2024 promises a return to stability and predictability in the reinsurance market.

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[1] https://instituteforlegalreform.com/blog/letter-urging-congress-to-expose-tplf/

[2] https://www.theinsurer.com/analysis/european-reinsurers-highlight-the-need-for-prudence-with-reserving-boosts/

[3] https://www.reuters.com/technology/cybersecurity/apple-backed-study-finds-rise-data-breaches-iphone-maker-defends-encryption-2023-12-07/#:~:text=Cybersecurity-,Apple%2Dbacked%20study%20finds%20rise%20in%20data%20breaches,iPhone%20maker%20defends%20encryption%20stance&text=Dec%207%20(Reuters)%20%2D%20In,was%20commissioned%20by%20Apple%20(AAPL.