U.S. Real Estate and Hospitality Market Update

FALL/WINTER 2022

Insurance | Risk Management | Consulting

Preparing for 2023

Throughout 2022, the aggregate insurance marketplace started to show signs of stabilization. While the numbers for Q3 2022 are still being finalized, data from the Council of Insurance Agents and Brokers shows that Q2 2022 marks the 19th consecutive quarter of rate increases.[1]

The devastation brought on by Hurricane Ian seems to have dashed any hope that a downward trend will appear into 2023.

Adequate replacement cost valuations or insurance to value (ITV) is mission critical for all property underwriters. Their focus on ITV has only intensified throughout 2022 and we expect that all insureds, regardless of size or geography, will feel this push from underwriters come December 31 and January 1 renewals. This time around, ITV concerns are expected to include calls for updated rent rolls in addition to building valuations.

The casualty insurance marketplace seems to have retired the massive knee-jerk reaction increases that were so common during the height of the pandemic. However, the market is highly loss sensitive. Certain asset classes and geographies may experience flat to high single-digit increases in primary general liability lines while other loss-prone asset classes and geographies will still see mid to high double-digit rate increases. Accounts with severity losses like assault and battery claims or claims resulting from fatalities will see the largest increases.

Management liability lines of coverage remain as one of the few bright pockets of the marketplace. The Directors & Officers liability marketplace saw 20+ new entrants who were attracted by the heightened rate activity. This has led to increased competition and most insureds with clean loss history could see decreases or flat renewals, especially in the excess layers.

Finally, rate increases for cyber liability may have seen their peak. Underwriters continue to focus on cyber security controls including requiring multifactor authentication for all remote access, 100% endpoint detection and hard copy segmented backups as a few examples. Insureds with clean loss history, best-in-class controls, and who have already experienced significant rate increases, may find that flat renewals or even rate decreases are possible. Insureds that don't meet these new underwriting requirements will still be unable to secure full coverage.

Maggie McIntyre who leads the Northeast region of Gallagher's Real Estate & Hospitality practice says "control the renewal process or it will control you." A considerable amount of the pricing insureds receive is a function of the marketplace, but insureds who optimize variables within their control will receive superior outcomes when navigating their own renewal process.

UNDERSTANDING THE FACTS

CONTROLLABLE VARIABLES

1 SUBMITTED REPLACEMENT COST VALUATIONS—INADEQUATE VALUATION WILL LEAD TO:

- Actual cash value endorsements
- Occurrence limit of liability endorsements
- Margin clauses
- Increased premiums

2 CARRIER PROPERTY RISK ENGINEERING

- Zero Tolerance for incomplete risk engineering recommendation by underwriters
- Noncompliance could result in an inability to secure quotes or non-renewals

3 MORE HISTORY, BIGGER PICTURE

- Some underwriters seeking as much as 10 years of umbrella/GL loss runs, no longer 5–7
- Offer more information to better control the narrative surrounding your risk profile, transparency is key

UNDERSTANDING THE FACTS

MARKET CONDITIONS

1 "SECONDARY" PERILS DRIVING LOSSES

- Wildfires, severe convective storms (hail, tornadoes) occurring in greater frequency and severity
- Percentage wind hail/deductibles are now the standard
- Water damage deductibles rising regardless of loss history, mid/high-rise buildings expect $100k+

2 SPECIALTY MGA PROGRAMS

- Insureds exiting a specialty program for the standard market should expect sticker shock

3 HEIGHTENED ATTACHMENT POINTS FOR UMBRELLA

- $2 million attachment for multifamily risks becoming more common
- Litigation financing continues to drive attritional losses

PROPERTY—UPSTREAM SUPPLY CRISIS, DOWNSTREAM PRICE INCREASES

In the insurance supply chain, the policyholder is the end user of coverage offered by a primary insurer. Primary insurers purchase reinsurance to cover years of exceptionally large losses that exceed a predetermined amount. In recent years, those large losses no longer seem exceptional, but rather common. As primary insurers are forced to draw upon reinsurance agreements, the costs are passed down to policyholders.

2017 marked a turning point in the marketplace when hurricanes Harvey (August 17), Irma (August 30), and Maria (September 16) made landfall in rapid succession resulting in $92 billion in insured losses.[4]

- Prior to 2017 Verisk reported that the 5-year average insured losses from natural catastrophes were $47 billion.[5]
- The same report details that since 2017, the five-year average for losses from natural catastrophes has more than doubled to $100 billion per year.

In addition to higher costs of coverage, these huge losses have led to retrenchment by reinsurers and a reduction in property CAT capacity.

- An AM Best study found that reinsurers paid $194.2 million in 2018, $513.1 million in 2019, $769.1 million in 2020, and $1.03 billion in 2021 to Florida personal property insurers alone.[6] As losses rise, the price must go up or capacity must come down.
- Retrenchment from reinsurers has put a tight squeeze on capacity and ABC News reports that before Hurricane Ian made landfall more than 12 insurers in the state of Florida had shut their doors.[7] This was due to an inability to secure reinsurance.
- Verisk models released in June of this year put the 2022 tally at $123 billion for the global average annual loss estimate.[8]

In years past, some mid-sized insureds were able to seek shelter from turbulent market conditions in super regional carriers who avoid writing business in heavy CAT-exposed areas like Florida or California. However, reinsurers work with a vast array of primary insurers and as they continue their retrenchment on the heels of these massive losses, primary insurers in all geographies are feeling the sting.

Insureds should expect to see property rate increases accelerating compared to prior quarters. CAT capacity will further tighten for named storm-exposed assets along the Gulf coast, especially for wood frame habitational risks. We expect carriers to continue to push seasonal wind/hail deductibles of 2% with some even pushing 3% to 5%.

HURRICANE IAN

The following numbers are preliminary estimates of insured losses from catastrophic risk modelers. As reported by Verisk, the average insured losses from natural catastrophes over the past five years is $100 billion. At the time of writing, the average estimate for Hurricane Ian is equal to $60 billion. Hurricane Ian is already expected to exceed half of the $100 billion average annual loss in a single event.

An RMS update on October 5, 2022 notes that Ian has the potential to be "one of the largest, if not the largest" insured catastrophe losses in U.S. history.[9]

Organization	Estimate (bns)	Date
Verisk	$57	10/03/2022
Core Logic	$53	10/07/2022
Fitch Ratings	$40	9/29/2022
RMS (Wind Only)	$74	10/07/2022
Stonybrook	$75	10/10/2022
Karen Clark & Co.	$63	9/30/2022
Average	**$60**	

[10,11]

CASUALTY

It is too early to say that the casualty market seems to have turned a new leaf, but a return to rational underwriting seems plausible. At the height of the COVID-19 pandemic, high double-digit rate increases on general liability, primary umbrella lines, and excess liability lines were commonplace. As these market conditions wane, we expect most insureds to receive rate increases in the flat to +9% range. Increases in the excess liability lines appear to be restricted to the first $25 million in limit. As we move up to higher layers we see additional competition for renewals.

For urban geographies, underwriters have turned a keen eye to crime scores. Three to five years ago, these seemed to be all but absent from the underwriting process. In the post-COVID world, underwriters of urban-based assets have put new stress on this metric as well as the application of assault and battery exclusions.

MANAGEMENT LIABILITY

The days when COVID-19 dominated the headlines seem to be nearly behind us, as the CDC recently announced it will no longer keep a log of country-by-country travel advisories. In a similar fashion, some of the panic associated with the possibility of COVID-19-related management liability claims has also subsided.

New market entrants attracted by the heightened rate activity have thrust capacity into the marketplace putting downward pressure on rates. Many executive leaders are now focusing on how to meet their firms' ESG (Environmental, Social and Governance) and DEI (Diversity, Equity and Inclusion) goals rather than COVID damage control. This will come with its own set of challenges. real estate firms should take note of the following market trends:

1. **Directors & Officers Liability**
   - Our Management Liability practice recently noted that[2]
     - » Reduced securities class action frequency, with a significant drop in merger-objection (M-O) cases, but also the numbers for core (non-M&A) securities cases are down;
     - » Core case dismissal rates continuing at nearly a 50% pace, and close to 90% dismissals for the more recent M-O cases;
     - » Many carriers have privately acknowledged improved loss ratios and new strategies for growth.

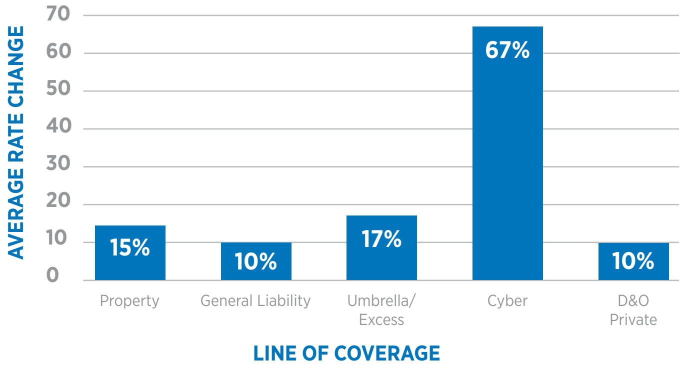
2. **Employment Practices Liability**
   - We are seeing a leveling off of rates after years of increases for most insureds. However, we are still observing increased retentions especially in high risk states such as California and New York.

3. **Crime**
   - Social Engineering losses have kept the pedal down on crime insurance rates. Most crime policies will sublimit this cover and underwriters are beginning to request specific controls to offer terms at all.

4. **Cyber Liability**
   - A mid-year 2022 report points out that this year alone has already seen an +11% increase in malware attacks totaling 2.8 billion attacks.[3]
   - Somewhat surprising is the fact that ransomware losses have not increased in 2022 as expected.

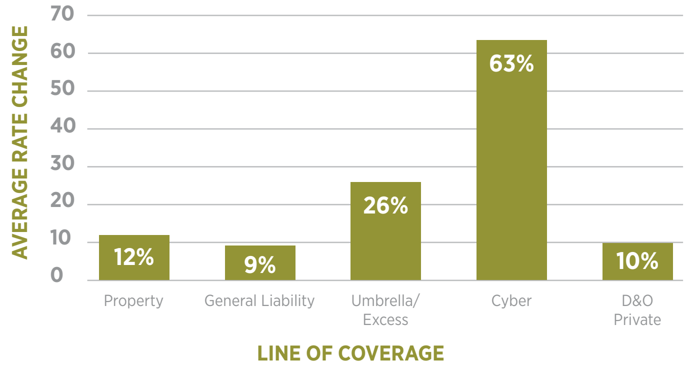
Marketplace Snapshot

Northwest Region



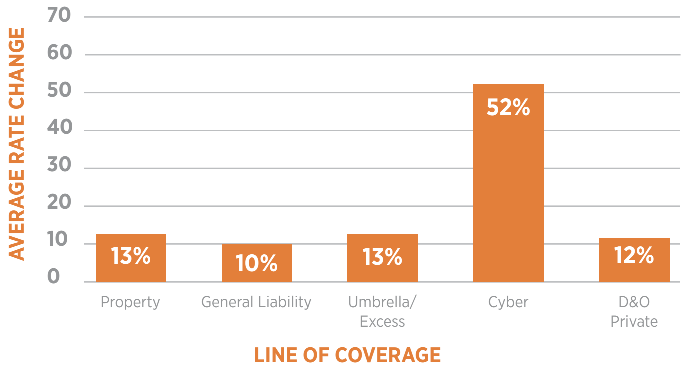
Northwest
Washington, Idaho, Montana, Oregon, Wyoming, California, Utah

Northeast Region



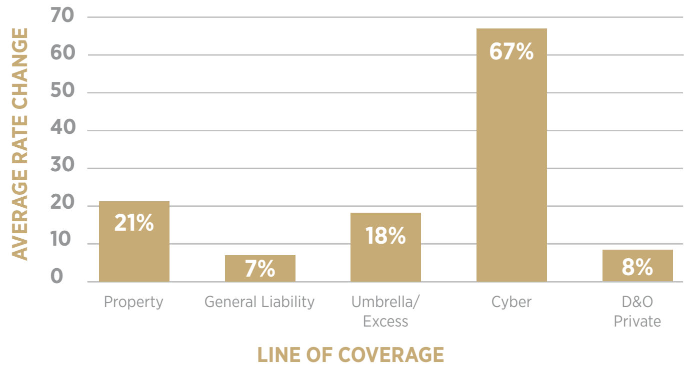
Northeast
Maine, Vermont, New Hampshire, Connecticut, New York, Rhode Island, Massachusetts, New Jersey, Delaware

Southwest Region



Southwest
California, Nevada, Arizona

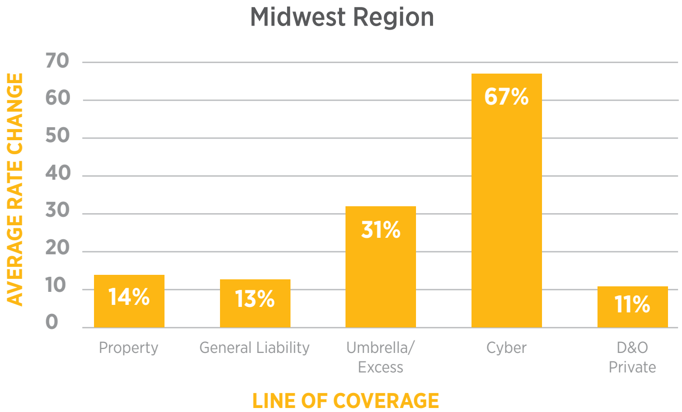
Southeast Region

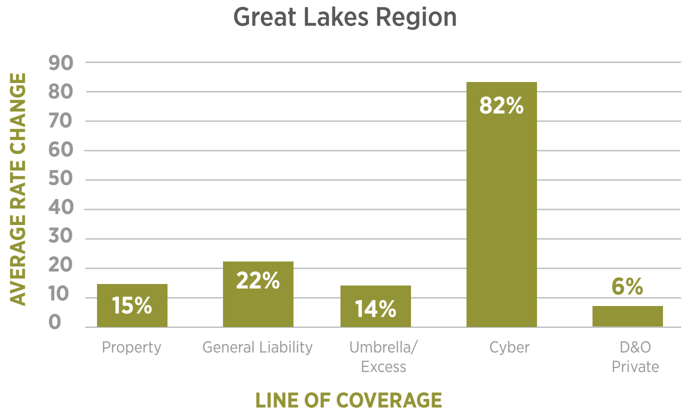


Southeast
North Carolina, South Carolina, Alabama, Georgia, Florida

**Please note that the following rates represent entire regional average rate changes metrics. They do not account for variables such as asset class, loss experience, increases/decreases in exposure base, etc. These should be used as bellwethers for the marketplace and individual renewal expectations should be discussed with your broker.

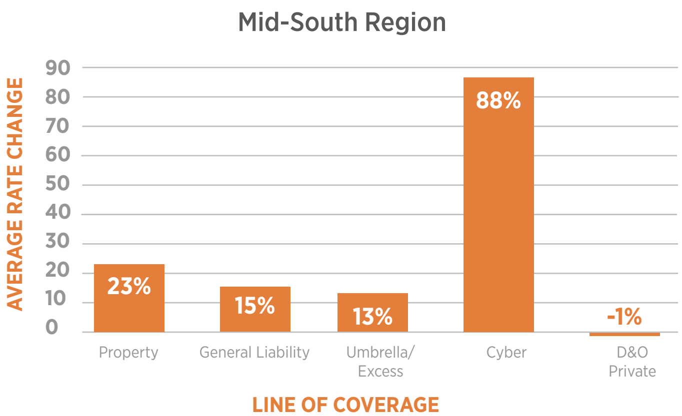
Marketplace Snapshot (continued)

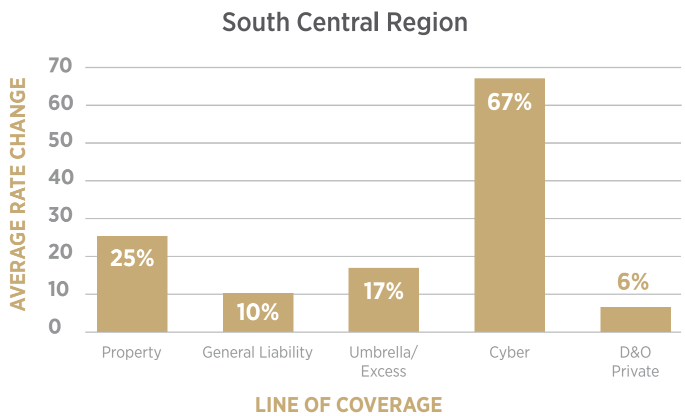




Midwest
South Dakota, Nebraska, Iowa, Illinois

Great Lakes
North Dakota, Minnesota, Wisconsin, Michigan, Indiana, Ohio, Pennsylvania





Mid-South
Maryland, Virginia, West Virginia, Kentucky, Tennessee, Mississippi, Arkansas, Louisiana

South Central
Missouri, Kansas, Oklahoma, Colorado, New Mexico, Texas

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Email update received from RMS Event Response