MARKETS IN FOCUS
REAL ESTATE

IMA

Insurance Pricing &
Market Update

Q3 2021

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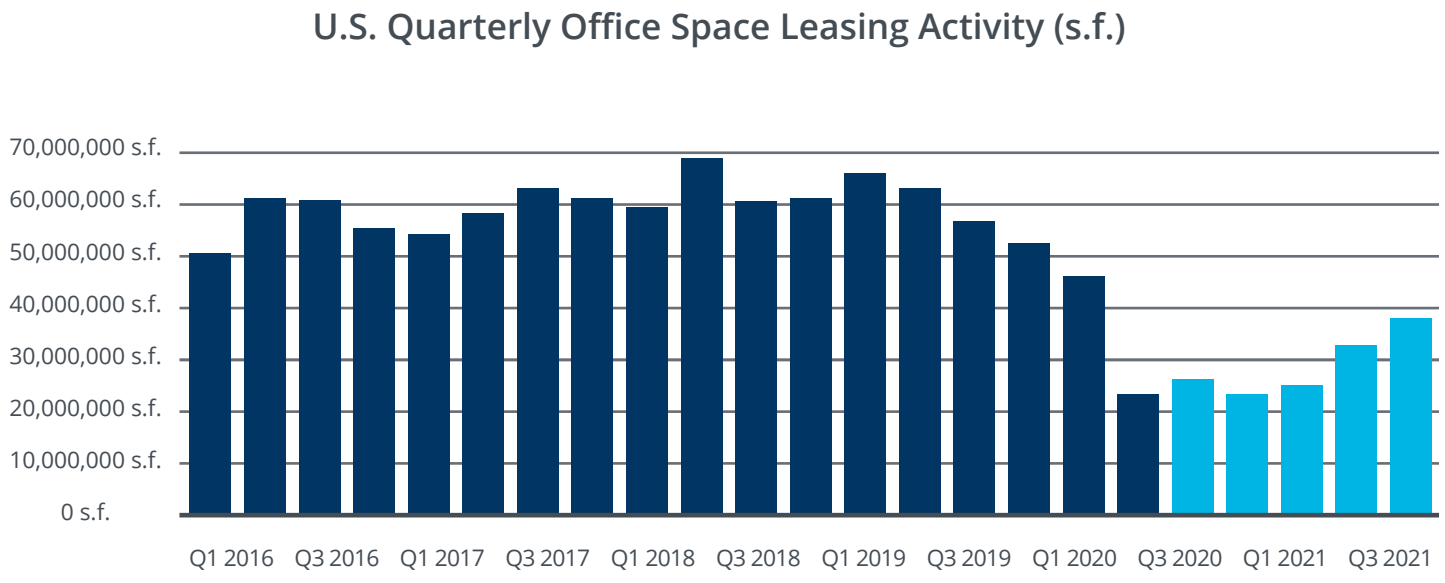
Introduction

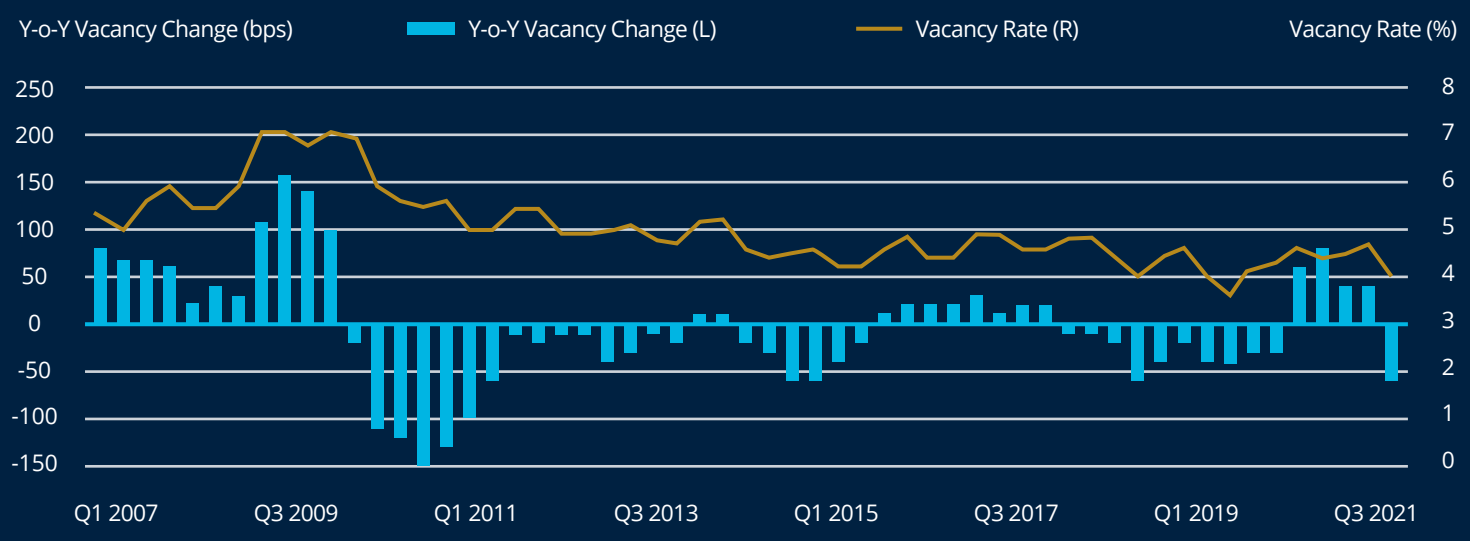
Though the global economy is in a much better place and vaccines have generally made it much safer for people to gather, the "Great Return" that many were hoping for to commercial office space in the back half of 2021 has not still not occurred. Whether it be concerns over the Delta variant or employers simply trying to adapt to employees' new desire to work more from home, office space leasing activity remains well below pre-pandemic levels. However, activity is up significantly from the lows of Q1 2021 and it is believed that this trend will continue into 2022.

On the other hand, the multifamily and industrial sectors continue to have strong performances throughout the pandemic. National apartment rents continue to climb, and vacancy rates saw their largest drop in Q2 2021 as inflation and increased housing demand continue to cause upward pricing pressure. As for the industrial side, warehouse space continues to be a hot commodity as the increase in e-commerce and the need for storage in a time where supply chain difficulties continue to be an everyday problem for most business have created significant pricing pressure for this sector. According to Chicago-based Cushman & Wakefield PLC, vacancy stood at 4.1% at the end of Q3 and average rents soared to $7.18 per square foot, both all-time records.[1]



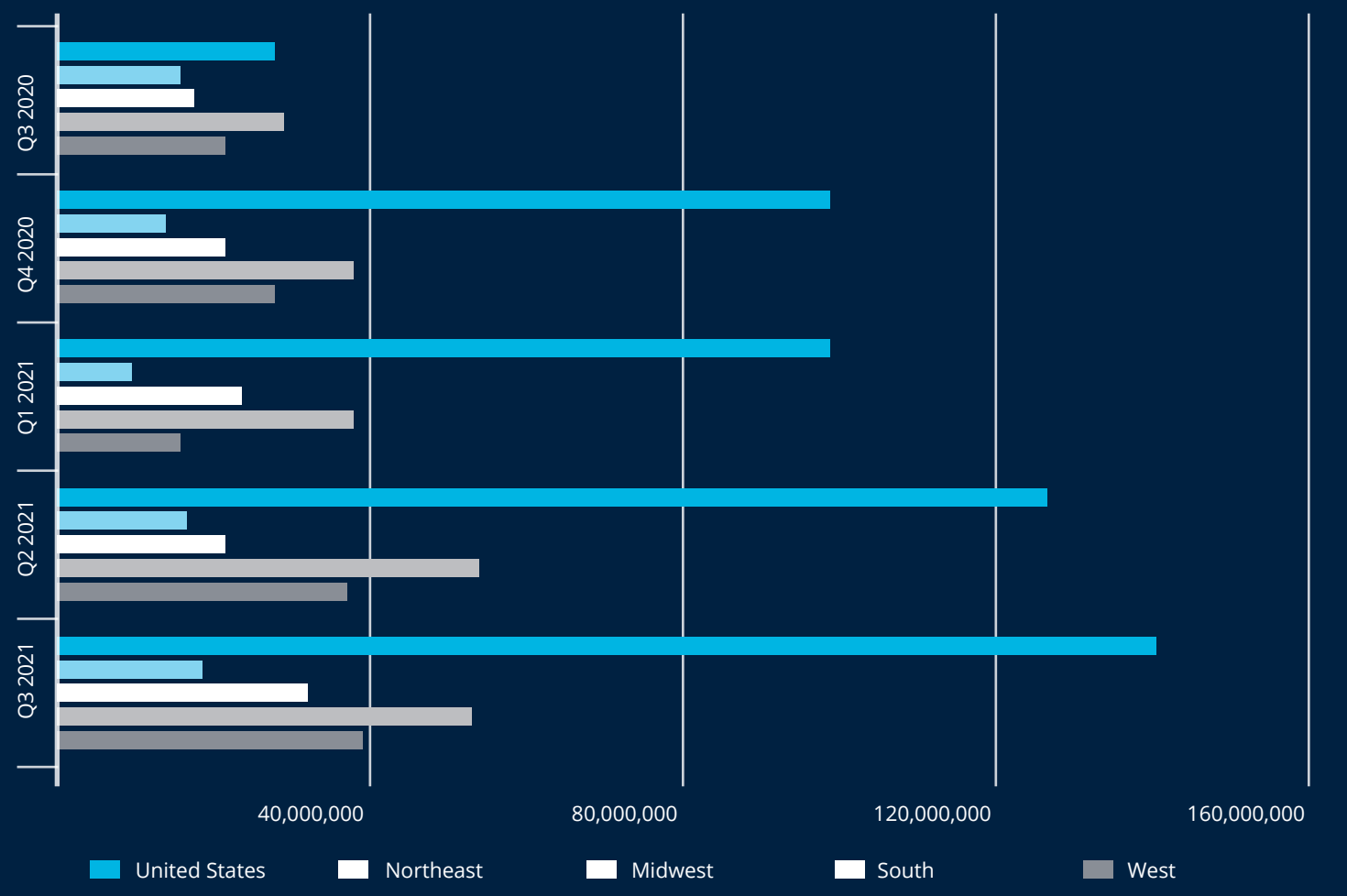
Source: JLL Research

U.S. Multifamily Vacancy Rates



Source: CBRE Research, CBRE Econometric Adivsors, Q2 2021.
Based on the 63rd legacy markets tracked by CBRE EA.

U.S. Industrial Market Net Absorption

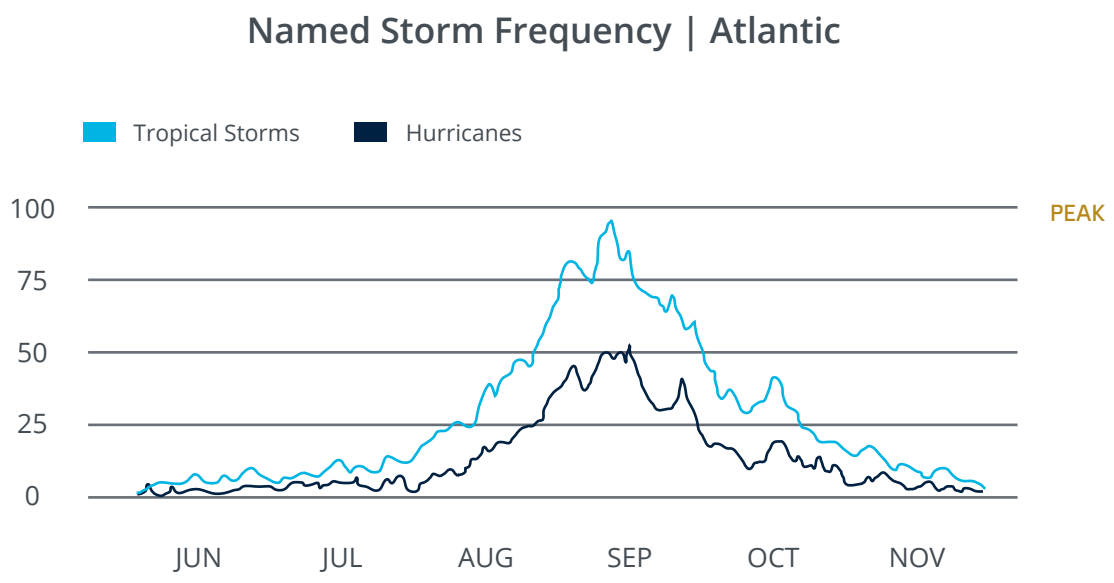


Source: Cushman & Wakefield PLC

Hurricane Ida

On 8/29/2021, the 16th anniversary of Hurricane Katrina, Hurricane Ida made landfall near Port Fourchon, Louisiana as a powerful Category 4 hurricane with sustained 150 mph winds. For Louisiana, the storm left hundreds of thousands of homes and business without power (mostly outside of New Orleans) for weeks, more than half the gas stations in two major cities were without fuel for nine days after the storm made landfall and 1 person died.[2] However, the carnage did not stop there. After slamming into Louisiana, Ida continued into the northeast and wreaked havoc in New York, New Jersey, Pennsylvania, and Connecticut. Due to the flooding and tornadoes caused by the remnants of Ida in the northeast, 43 total people were killed, 150,000 homes were left without power and portions of New York City's subway system were significantly damaged by flooding.[3] Prior to Ida making its way towards the northeast, insurance loss estimates were in the $10B to $15B range, but new estimates by modeling firm AIR Worldwide have pegged insurance losses in the $31B to $44B range.[4]

Utilizing these loss estimates, Ida is the largest catastrophic (CAT) event in the U.S. in 2021 to date and will most likely be the largest CAT event for all of 2021. For comparison, Winter Storm Uri, which caused significant damage in Texas in February and was considered the costliest U.S. CAT event in 2021 before Hurricane Ida, is only estimated to have caused half the amount of insurance losses as Ida.[5] Losses from this disastrous storm will certainly reverberate throughout the entire property insurance market, not just coastal properties, but at this moment it is hard to assess the true impact as losses are still being calculated. Reinsurance carriers will be handed a significant bill for Ida's losses, which could add upward pricing pressure to property rates as carriers anticipate increases in their reinsurance costs. Hopefully this will be the last large storm that impacts the U.S. as peak hurricane season ends.



https://weather.com/storms/hurricane/news/2020-07-22-atlantic-hurricane-season-peak-august-september

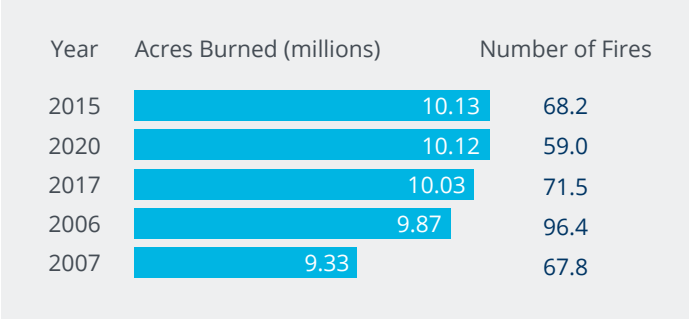
2021 Wildfires

In addition to Hurricane Ida, the property insurance market has also been significantly impacted by multiple years of difficult wildfire seasons. In 2021, unseasonably warm weather and droughts resulted in a series of wildfires in the western U.S. that started in early May (a month before they typically do) and continues to be a problem even through October. As of September 23, the National Interagency Fire Center's (NIFC) situation report listed a total of 45,518 wildfires across the country that had burned more than 5.8 million acres.[6] Comparatively, in 2020, one of the five worst wildfire years since 1960, 43,556 fires burned 6.9 million acres from 1/1/2020 through 9/19/2020 and a total of 58,950 wildfires burned 10.1 million total acres in 2020.[7]

40% of the 10.1 million acres burned in 2020 were in California, and that trend has continued into 2021.[8] As of September 30, there have been 7,064 fires in California resulting in 2 million acres burned, 3,050 structures damaged or destroyed and 1 fatality in 2021.[9] Californians and property insurers that write policies in California are no strangers to wildfires, but the severity and widespread destruction of these fires has intensified in recent years. In 2020 and 2021, the state saw their two largest fires in recorded history – the August Complex fire burned 1 million acres in Mendocino National Forest and the Dixie fire in July 2021 burned 963,301 acres in the Plumas and Lassen National Parks. For scale, both fires burned an area larger than the state of Rhode Island. Additionally, the California wildfires continue to impact the entire state from the California-Oregon border, over to Lake Tahoe and all the way down to Malibu and San Diego. Property insurers are taking note of this and are limiting capacity to California, increasing rates or adding higher specific retentions for wildfires.

California is not the only state experiencing tightening in the property market as a result of wildfires. With years where 10 million acres are burned in wildfires becoming the norm, other western states like Oregon (which experienced its third worst wildfire in their state's history this year[10]), Colorado, Washington, Utah, Montana and Idaho are also experiencing some tightening in the property market. As climate change continues to impact weather patterns and droughts, it appears that wildfires will continue to play a factor in the property market and will need to be monitored moving forward.

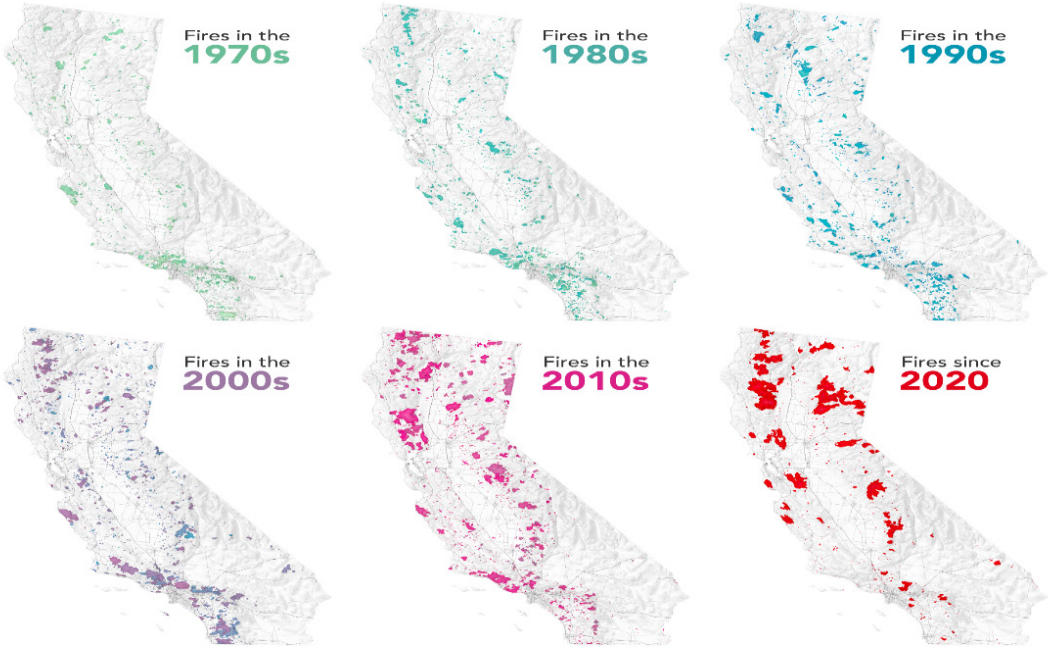
Top Five Years with Largest Wildfire Acreage Burned Since 1960 in the U.S.



Source: NICC Wildland Fire Summary and Statistics annual reports
Note: Number of fores in thousands

California's Wildfires are Growing

Simply put, the fires of recent years dwarf those of previous decades[15]

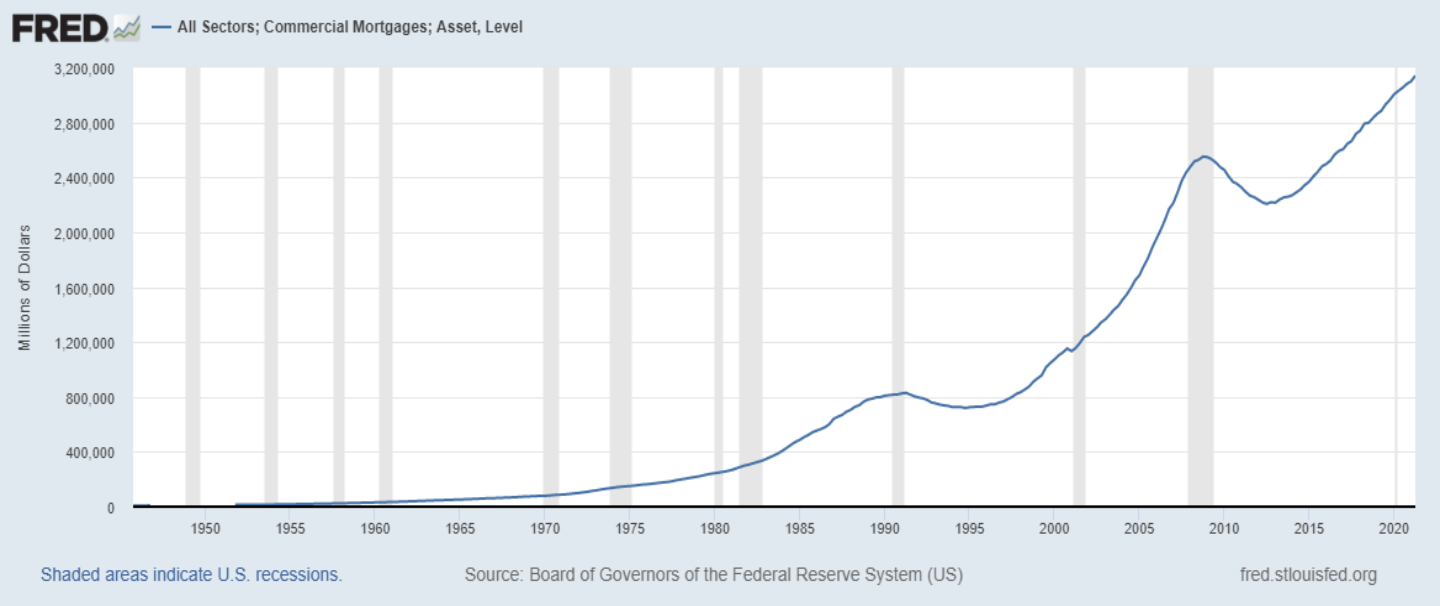


Trouble in the Chinese Real Estate Sector

Another major recent development that the global real estate market needs to keep their eye on in 2021 and beyond is the financial strength of the Chinese real estate industry. In September and early October, Evergrande, China's largest and most indebted real estate developer with over $300B in debt, missed three interest payments in aggregate total of $267 million.[11] In October Fantasia Holdings (a luxury apartment developer in China) failed to pay $315 million owed to lenders, Sinic Holdings (a Chinese homebuilder) failed to pay $250 million owed to lenders and China Properties Group (a multifamily developer in China) failed to pay lenders $226 million with all three companies saying they will most likely default on these debts at the end of their 30-day grace period.[12] Furthermore, debt rating agencies have significantly downgraded other major developers such as China Aoyuan, Modern Land, Greenland Holding (which has prestigious properties in New York, London, and Sydney) and the Chinese real estate sector as a whole.[12]

Much of the turmoil comes on the back of Chinese President Xi Jinping's decision to crackdown on the Chinese real estate industry as a whole this summer by increasing mortgage rates in major cities, accelerating the development of government subsidized rental housing, and increased scrutiny on everything from financing of developers and newly-listed home prices to title transfers.[13] As China's economy slows and President Xi tries to increase the nation's birth rate, the policies underscore the Communist Party's growing resolve to respond to mounting dissatisfaction with hoarded wealth and narrowing avenues for advancement in order to avoid social unrest.[13] Though President Xi has made strong public statements around not providing government assistance to the beleaguered real estate industry, the government has been working behind the scenes to convince state-owned companies to acquire the assets of the distressed real estate firms.[14] For example, the government facilitated Evergrande's sale of their 20% stake in Shengjing Bank to state-owned Shenyang Shengjing Finance Investment Group.[14] At this moment, it is unclear what the Chinese government will do if forced to provide financial assistance to the real estate sector, but appears that they want to avoid civil unrest and major impacts on the global economy.

With that said, one might be wondering how this will have any impact on the U.S. real estate market? Though China's real estate woes appear to be contained with their country and their banking system, many other Chinese developers have significant investments in the U.S. via REITs and actual physical assets. Furthermore, many western lenders and investors have significant exposure to Chinese developers (as evidenced by Blackrock's $170 million exposure to Evergrande), and a rash of defaults could result in a credit crunch for the industry. Directors and Officers insurance underwriters are certainly keeping their eye on these developments given their level of concern that defaults could lead to bankruptcies and therefore an uptick in D&O claims.



Q4 2021 Insurance Market Outlook

Many of the factors that lead to increased pricing pressure in 2021 have sustained throughout 2021 and will most likely continue into Q4 2021 and 2022. The U.S. remains in a low interest rate environment (which makes it hard for insurance companies to offset losses with investment income), traditional inflation and social inflation continue to increase the cost of claims and natural disasters continue to plague the U.S. and Europe. Additionally, another tough wildfire season has been especially problematic in California and the Pacific Northwest and multiple hurricanes made landfall early in the hurricane season. As such, admitted and E&S carriers will continue to place an emphasis on disciplined underwriting and reshaping their portfolios to maximize profitability.

This has especially been true for admitted carriers in 2021, and accounts continue to be placed in the E&S market for all industries and sectors even if they have not traditionally been placed in this market before. E&S carriers are often better equipped to implement pricing and policy language more in line with the current risks in the market. It is expected that larger Property and Umbrella/Excess programs in the space will require more carriers to achieve desired limits in the remainder of 2021 and 2022 as carriers once providing $15 million to $20 million layers will now offer reduced $5 million to $10 million layers.

+ **Property** – Generally speaking, there continues to be sufficient capacity in the property market, but availability is dependent on risk perception and rate. Placing multifamily property continues to be a challenge, particularly in Texas and Florida given these state's CAT exposure and questions raised around quality control given the recent Florida condo collapse. Additionally, many carriers in the property market are concerned about the ongoing nationwide shortage of building materials and labor that is having an inflationary impact on property value. Carriers continue to struggle with the gap between what is reported as replacement value when underwriting the policy vs actual cost when a claim occurs. Furthermore, January is a very important month for carriers since that is when many of them procure their reinsurance treaties. As such, given another year of significant CAT losses and the anticipated upward pricing pressure this will create, all eyes will once again be on reinsurance rates since these costs significantly impact pricing for carriers.

+ As admitted property carriers continue to recalibrate their portfolios and evaluate how much exposure they truly want in certain geographies, the E&S market will continue to be an important outlet for property insurance capacity to the Real Estate sector. Both admitted and E&S carriers remain wary of insuring property exposed to catastrophic storms (such as coastal properties) and are simply declining submissions with excess wildfire exposures. Furthermore, in regions with more CAT exposure such as the West Coast, the Southwest, and the Southeast, the E&S market might be the only option for coverage – especially at the primary layers. As of Q2 2021, the E&S Stamping Office reporting a 22% YTD growth in the top E&S states of California and Texas.

- **Builder's Risk** – Like other markets, Builder's Risk policies are seeing increases in pricing and retentions not only due to significant losses as a result of large fires but also an increased frequency of smaller claims. Large wood frame, modular construction, and renovation projects continue to be the most challenging projects to place. Overall, rate increases are becoming more common given the current demand and price for lumber and other building materials. Additionally, due to delays in projects as a result in labor shortages and supply chain issues, many insured are seeking extensions, which can be problematic for carriers.

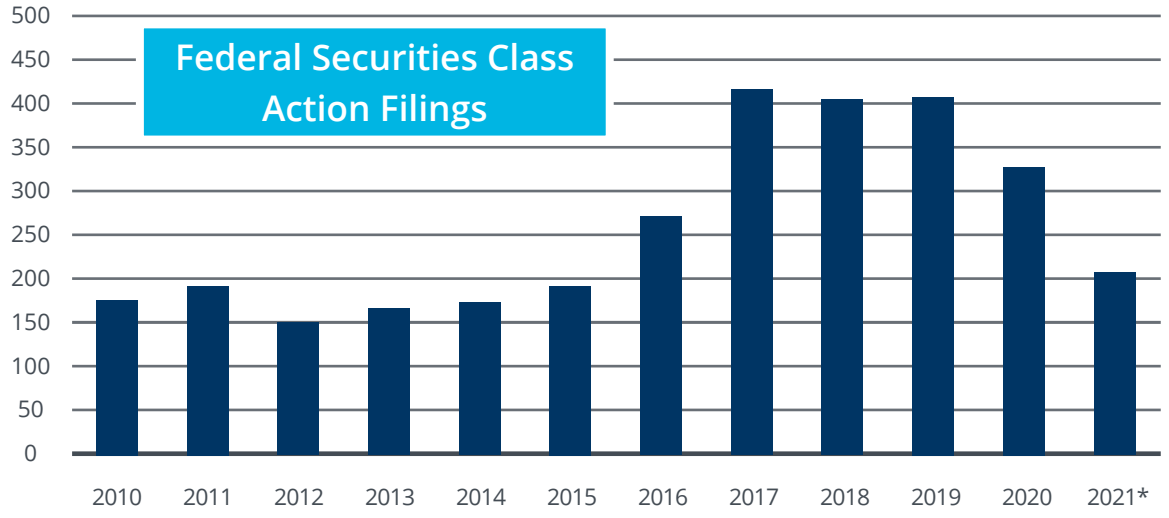
- **Casualty** – Capacity in the casualty market continues to be very tight in the real estate space, primarily for the multifamily sector. Like other industries, the real estate space is finding it difficult to obtain more than $1 or $2 million in General Liability limits and Umbrella/Excess carriers are only willing to expose $5 million within the first $10 million of excess limits. Carrier appetite above the $25 million attachment point is better, but even excess of $25 million we are seeing a greater need for quota share and layered participation. Casualty carrier decisions continue to be driven by the fear of nuclear verdicts and the overall impact inflation has on the cost of paying claims. Given the higher exposure to losses that habitational tenants have versus the commercial oriented real estate sectors, underwriters have become extremely cautious in this space.

- In response to COVID-19, many General Liability carriers added communicable disease exclusions and habitability exclusions, which are claims related to landlords failing to maintain "habitable" properties. California tends to see the highest number of claims and losses in this category, but lawsuits from these types of claims could spread into other states as the Delta variant continues to impact the state. Additionally, vaccine status could enter the realm of conversation for what is considered a "habitable" property which could also provide additional uncovered issues for property managers.

- Excess/Umbrella underwriters, like General Liability underwriters, are also very concerned about nuclear verdicts and if an insured's loss history is indicative of a potential large loss. This is especially true for companies with large auto fleets, as Auto continues to be a loss leader for carriers and is also starting to impact Umbrella/Excess pricing. As such, underwriters are requiring longer history of loss information as well as more details related to losses and any subsequent changes made to prevent future loss.

Executive Liability Update & Outlook

+ **D&O** – Given the rash of bankruptcies in 2020, the rise of SPACs and M&A activity, and the overall global economic uncertainty caused by COVID-19, D&O pricing increased significantly, and capacity shrunk across all industry sectors. However, despite these concerns, D&O claim filings have trended downward in 2021 compared to 2020 and even 2019 and 2018. Through 1H21, there have only been 108 total Federal Securities Class Action Claims which represents a 38.6% decrease from 1H20. Filing rates through September 2021 imply an annualized IMA estimate of 207 total filings in 2021, which would represent a year-over-year decrease of 36% compared to 2020. Given this downward trend, elevated lawsuit dismissal rates, new capacity entering the marketplace, and an improved broader economic outlook versus one year ago, D&O pricing for recent renewals has consistently been more favorable than year ago levels. Companies considering an IPO or a de-SPAC transaction should continue to expect elevated pricing and retentions, but both are generally more favorable that a year ago. As for REITs, underwriters are still focused on the likelihood of net asset value (NAV) decline, free cash flow generation for distribution payments and project timelines for new builds but pricing and capacity is generally favorable.



**2021 full year estimate based on actual filings through September (155)*

+ **Cyber** – With cyberattacks on the rise, real estate developers and managers would be prudent to consider a Cyber Insurance policy. Contrary to popular belief, the most heavily cyberattacked firms are those in the 11 to 100 (30.2% of all attacks) and 101 to 1,000 (35.7% of all attacks) employee count range, which describes many companies in the space. The most common attacks are phishing, ransomware, and cyber extortion and many threat actors are gaining access through unsecure Wi-Fi networks or Internet of Things (IoT) devices. As more and more high-profile attacks make news headlines, the market is responding by increasing prices and diminishing capacity. Capacity constraints are being slightly offset by the emergence of InsurTech firms, who are moving beyond static questionnaires and using technology for underwriting or risk assessment. Regardless of the carrier, insureds will need to prove that they have sophisticated cybersecurity controls in place in order to even receive a quote.

Navigating the remainder of 2021

+ **Building Valuations** – As mentioned previously, the pandemic continues to have a major impact on supply chains and labor markets which has led to rising prices around the world. As such, insureds should evaluate if their limits can adequately cover a total loss and rebuild in the current cost environment. To aid in confirming values are being reported on a replacement cost basis, indices detailing cost trends by geographic area and type of occupancy are available, providing a cost trend factor to apply based on the current age of the value currently scheduled or the original value of that asset.

+ **The Great Resignation** – Beginning in April 2021, the U.S. economy has experienced a great phenomenon that many are referring to as the "The Great Resignation" in which workers across the country resigned from their jobs in record numbers and are not actively looking for new employment. As such, many tenants in habitational assets may now be unemployed and are living off savings, thus increasing the risk of late rents. Given the general state of the job market, many believe that these people could easily find new work and reenter the labor force, but this is something to keep an eye on for the real estate sector.

+ **Vacancy Exclusions** – Many Property polices include provisions which remove or restrict coverage when a building is deemed vacant. Typically, vacancy restrictions are triggered by a percentage of occupancy for a consecutive number of days (often 60 to 90) but they can also be triggered if the building has been repurposed from its originally intended use. The day trigger can sometimes be negotiated with underwriters prior to renewal, but they are less likely to negotiate percentage of occupancy or changes in intended use. For buildings with exceptionally low occupancy, underwriters may require evidence of building safeguards (i.e. cameras, alarms, etc.) before issuing coverage. Many carriers may opt to use these exclusions given rising concerns about the numerous hazards associated with vacant buildings, including bursting water pipes, fires, vandalism, and damage caused by vagrants. However, insureds can improve their position in the market by highlighting their security programs and protection measures in place during their submission process.

+ **Maintenance and Inspections** – Given the recent events in Florida, many Property underwriters in the multifamily space are now interested in seeing the latest engineering and structural integrity reports as part of their underwriting process. If these inspections have not been performed in a while, it would be prudent to considering having this done in order to appease Property underwriters in what has become a different segment to obtain favorable pricing and terms.

Keys to Success in 2022

+ **Begin the Renewal Process Early** – The General Liability, Excess/Umbrella, and Property markets have become constrained and more difficult to navigate in the hard market. Additionally, many blue-chip admitted carriers in the real estate space are offering less capacity and more carriers are being required to achieve desired limits. Due to general price increases across all lines of coverage and all industry sectors, underwriters are being inundated with submissions as brokers and insureds look to minimize the additional costs. As such, turnaround times for quotes are increasing. In order to achieve the best results, insureds should begin their renewal processes earlier than usual as to allow for brokers to successfully canvas the market, work diligently with underwriters in detail and negotiate the best terms.

+ **Prepare for Extreme Weather** – As hurricane Ida taught us, hurricane damage can span much further than the gulf coast and the Carolinas these days. Protecting assets from inclement weather, even for events that do not normally impact your geographical area, may be worth investigating. IMA risk control professional can help with this process via safety audits, helping upgrade process and procedures and on-site trainings.

+ **Highlight Safeguards** – When working through submissions documents, highlight protective safeguard features in buildings and share specific details on security systems, insurance requirements of tenants, water sensors, sprinkler systems, building enhancements and anything else that would demonstrate diligent care of property. It will be important to demonstrate to carriers that insureds are investing in their properties and doing their best to protect from total losses. In a time when it is hard for accounts to get individual attention and standout in an underwriter's stack these details can help a submission go further.

+ **Reevaluate the Cost to Get Buildings Rebuilt –** As mentioned previously, construction costs are on the rise due to multiple factors. This is not expected to decline as the construction industry is forecasted to see an overall increase in demand in 2021 and 2022. Insured should look to reevaluate the cost to repair their buildings in the current market prices in order to obtain adequate limits.

+ **Highlight Maintenance Program –** Share details on maintenance programs, winterization precautions, and details regarding improvements and betterments, particularly if the property is older, in an area exposed to natural catastrophes or if occupancy has dropped. After Winter Storm Uri, many property carriers are interested in the integrity of pipes and what insureds are doing to protect their property in cases of extreme weather. Carriers may also want to ensure that properties are still receiving planned maintenance when occupancy drops, despite negative impacts to cash flow as leaks and other problems may take more time to notice and thus cause more damage.

1 https://www.bizjournals.com/bizjournals/news/2021/10/07/us-industrial-market-shatters-records-q3.html
2 https://apnews.com/article/hurricane-ida-environment-and-nature-louisiana-business-storms-e85a71b868ecb2bad31e6d32ee478315
3 https://www.nytimes.com/live/2021/09/02/nyregion/nyc-storm
4 https://www.businessinsurance.com/article/20210916/NEWS06/912344585/Hurricane-Ida-loss-estimate-up-to-$44B-RMS?utm_campaign=BI20210916DailyBriefing&utm_medium=email&utm_source=ActiveCampaign&vgo_ee=OxEpqcKB7FweeGuodjz%2Bvgq14xnlT3gn9aJEyXnV9cQ%3D&utm_campaign=BI20210916DailyBriefing&utm_medium=email&utm_source=ActiveCampaign&vgo_ee=OxEpqcKB7FweeGuodjz%2Bvgq14xnlT3gn9aJEyXnV9cQ%3D
5 https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/losses-from-winter-storm-insouthern-us-expected-to-reach-historic-levels-62766641
6 https://disasterphilanthropy.org/disaster/2021-north-american-wildfire-season/
7 https://www.iii.org/fact-statistic/facts-statistics-wildfires
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14 https://edition.cnn.com/2021/09/29/investing/evergrande-stock-debt-crisis-intl-hnk/index.html
15 https://earthobservatory.nasa.gov/images/148908/whats-behind-californias-surge-of-large-fires

More Than Just Insurance

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