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COMMERCIAL INSURANCE

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RISK MANAGEMENT

SURETY

COMMERCIAL REAL ESTATE

Markets in Focus

Insurance Pricing & Market Update

Q2 2023

INTRODUCTION

U.S. commercial real estate investment activity is slowing as the nation's economy slips toward a possible recession. Deal volume will decline 15% this year. In a CBRE survey, 60% of investors indicated they would reduce purchases in 2023, most by more than 10%, while only 15% of respondents stated they would increase their activity.[1]

The outlook for the major commercial real estate categories contains few surprises and the data reflects the prevalent economic situations that have been thoroughly reported in this country. The slow return to offices and higher permanent levels of work from home and hybrid work arrangements are depressing the office market. High mortgage rates and stubbornly high single-family housing prices (propped up by cash buyers) are driving a strong multifamily commercial real estate market. And the recent extremely robust industrial market (especially for warehouse space) is softening as the economy slows and consumer spending declines after higher levels of pandemic spending.

Developers and commercial real estate investors are experiencing dramatic commercial property insurance rate increases. Historic high CAT losses over the last few years coupled with severe weather in many regions of the country are driving the rates higher. Lenders are increasingly requiring properties to be insured to replacement value, offering few opportunities to reduce limits, increase deductibles or utilize similar risk retention strategies.

To make matters even more challenging, as inflation and shortages of critical building supplies and labor drive full property replacement costs higher, insurers are becoming more insistent that valuations are current and based on appraisals or at least frequently adjusted based on justifiable indexes.

Access to capital is another concern top of mind for commercial real estate investors. The cost of capital is only part of the issue. Fed actions are putting stress on small and midsize banks, which account for 80% of commercial real estate lending.[2] These banks will likely need to tighten their lending criteria and reduce their loan portfolios. In some markets, private funds are stepping in to fill the gap.[3]

"60% of investors indicated they would reduce purchases in 2023."

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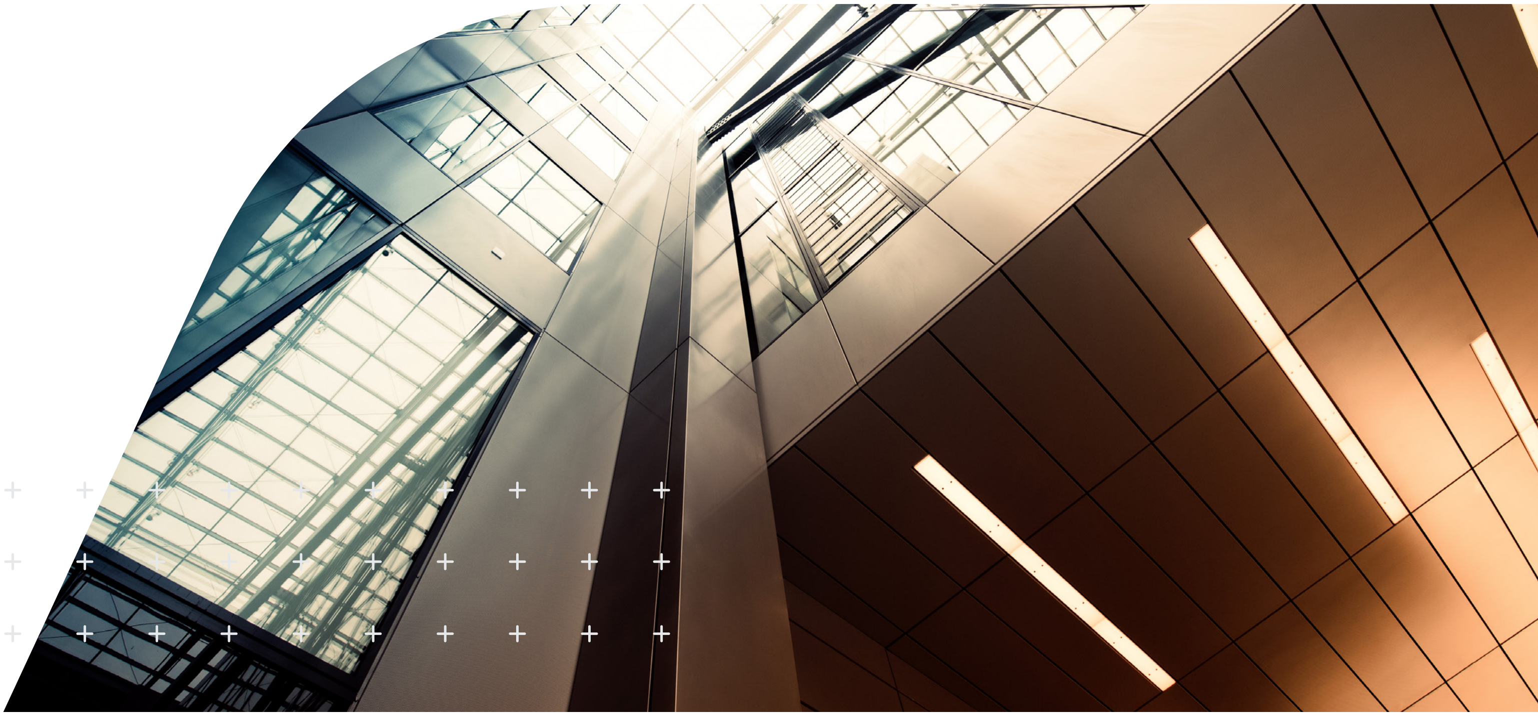
INSURANCE LINKED SECURITIES (ILS)

Historically, ILS have provided attractive returns relative to other fixed-income investments, but their performance can be volatile due to their exposure to catastrophic events such as hurricanes, earthquakes or pandemics. In recent years, the ILS market has experienced several significant catastrophic events, including hurricanes Ian, Harvey, Irma and Maria in 2017 and Hurricane Dorian in 2019, which have impacted the performance of ILS.

Despite these challenges, the ILS market has remained resilient and has continued to attract investors seeking diversification and exposure to alternative sources of return. In 2021, the ILS market saw a surge in demand from investors seeking higher yields in a low-interest-rate environment, and the market has continued to innovate with new structures and products, such as parametric insurance and cat bonds, that provide greater flexibility and customization.



INSURANCE MARKET OVERVIEW

PROPERTY

+ The commercial property insurance market has been impacted by a series of natural disasters in recent years, including hurricanes, floods, wildfires and severe weather events. These events have led to an increase in claims and losses for insurers, which has affected pricing and availability of coverage.

+ Insurers are responding to these challenges by tightening underwriting standards, increasing premiums and greatly reducing their line sizes in many cases.

+ Despite these challenges, the commercial property insurance market remains competitive, with many insurers still vying for market share. Some insurers are introducing new products or expanding into new geographic regions in order to grow their business.

+ Technology is also playing an increasingly important role in the commercial property insurance market, with insurers leveraging data analytics, artificial intelligence and other tools to improve underwriting, claims processing and customer service.

+ Insurers are also paying closer attention to emerging risks, such as cyber threats and climate change and are developing new products and services to address these risks.

+ Finally, regulatory changes and legal developments are also impacting the commercial property insurance market, with insurers having to adapt to new rules and requirements in order to remain compliant and avoid potential liabilities.

+ Insurance to Value (ITV) is becoming increasingly important as the costs of Commercial Property are rising; this is due to carriers now requiring that building values be increased, particularly if they have not been adjusted in a while.[4] If damage were to occur, insurers may be forced to pay out more money for replacement or rebuilding than they did previously.[4]

+ Wide use of the “double-double-half” rule for CAT prone areas (double premium, double valuation, half the capacity).

"Insurers are also paying closer attention to emerging risks, such as cyber threats and climate change."

GENERAL PRICING ESTIMATES

Non-CAT exposed property with favorable loss history	10% to 15% increases
CAT exposed property with favorable loss history	15% to 25% increases
Property with unfavorable loss history and/or a lack of demonstrated commitment to risk improvement (unresolved recs, pattern of same issues, etc.)	10%+ increases for non-CAT 30% to 50%+ increases for CAT exposed accounts and higher depending on frequency/severity of losses and when there are limited markets for a risk due to occupancy/class of business or concerns related to loss control

"[I]nsurers are **tightening their underwriting standards, increasing premiums**, and **reducing capacity**."

CASUALTY

General Liability

+ The General Liability market is currently experiencing a stressful environment, which means that insurers are tightening their underwriting standards, increasing premiums and reducing capacity.

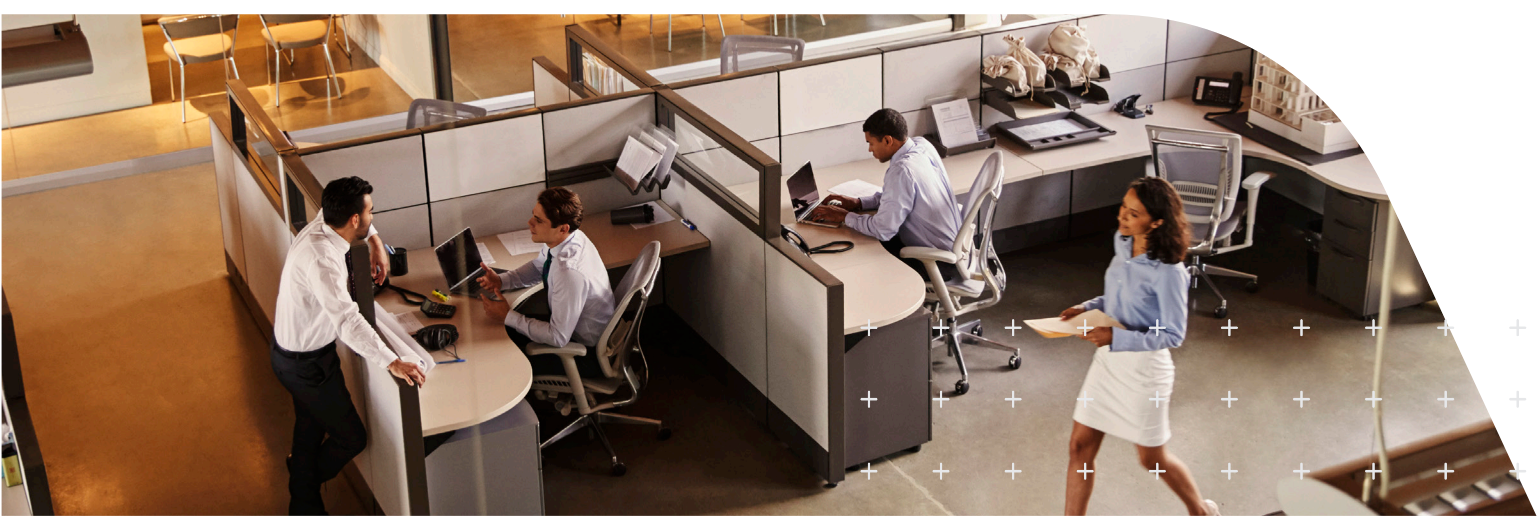
+ One of the main reasons for the hardening cycle is an increase in claim severity and frequency.

+ Insurers are also facing higher reinsurance costs and low investment returns, which are putting pressure on their profitability and capacity to write new business.

+ As a result, many insureds are experiencing rate increases, coverage restrictions and more rigorous underwriting requirements, especially in high-risk industries.

+ However, there are still opportunities for insureds to negotiate favorable terms and conditions by demonstrating strong risk management practices, having a favorable claims history and working with experienced brokers and underwriters.

+ The General Liability market is expected to remain challenging in the near term, but insurers and insureds alike are looking for ways to adapt and innovate in response to these market conditions.



Excess Liability

- In order to minimize the risk of loss, carriers are now offering excess coverage tiers below the traditional $25M, ranging from $5M to $15M. To reach the desired coverage limit, the number of carriers to achieve this is three-fold.
- Businesses that are particularly difficult to insure due to a high risk of significant losses include those engaged in wildfire, hazardous products, transportation, habitational, hotels, public entities, higher education, residential, New York construction and any risk with a history of poor loss performance.[5]
- Due to the comeback of some carriers to certain industries, as well as the entry of new carriers and MGA's, the excess market has seen an increase in submissions.[5] Unfortunately, the large quantity of requests has not been accompanied by an adequate number of knowledgeable underwriters to handle them.[5]

GENERAL PRICING ESTIMATES

General Liability	Up 5% to 10%
Umbrella & Excess Liability – Middle Market	Up 10% to 25%+
Umbrella & Excess Liability – Risk Management and other Complex/ Hazardous Exposures	Up 25% to 150%

Workers' Compensation

+ Carriers have found success in offering workers' compensation insurance, which provides buyers with competitive rates based on Modification Factors and their loss history. Accounts with few losses can take advantage of the competition between carriers to get more affordable premiums.

Auto

+ The commercial auto industry has been struggling, with payouts from settlements and claims far outweighing profits.[6] To combat this, many carriers have turned to telematics and fleet monitoring systems to help reduce their losses. This new technology is providing a much-needed reprieve for those managing large fleets of vehicles.[6]

GENERAL PRICING ESTIMATES

Workers' Compensation	Flat to Down 5%
Auto	Up 10% to 25% Up 30%+ if large fleet and/or poor loss history

"The cyber insurance marketplace has seen an uptick in the frequency of **data privacy liability suits**."

CYBER

+ The cyber liability marketplace has seen a surge in new entrants and additional underwriting capacity in the past 12 months, which has resulted in a more favorable underwriting environment for current and prospective insureds.

+ Businesses that can illustrate that they have best-in-class IT security and cyber incident response procedures are able to pursue rate decreases on their cyber insurance programs by leveraging the market.

+ Although the frequency of cyber liability claims is consistent, the severity (or cost) of cyber incidents has gone down over the past year. The consensus in the marketplace is that investing in IT security tools has a meaningful impact on an insured's cyber risk profile.

+ Loss of cash via social engineering and invoice manipulation emanating from business email compromise has become the most common cyber incident over the past year, as cyber criminals can more easily use business email compromise and employee activity to leverage a business for several thousands of dollars. Ransomware and malware attacks are perceived as more complicated and therefore harder to accomplish.

+ **Third-party and Vendor Cyber Liability**: The cyber insurance marketplace has seen an uptick in the frequency of data privacy liability suits stemming from breaches at third parties such as property managers and other vendors that help a property owner run or manage their portfolio. Property owners may have little or no direct interaction with the tenants residing at the buildings they own, but there is still potential liability that should be addressed. Property owners should consider requiring certain IT security standards and/or cyber insurance requirements in the contracts with their key vendors and business partners that manage or process sensitive data on their behalf.

GENERAL PRICING ESTIMATES

Cyber	+/-5% largely dependent on claims history and current IT security posture

MAJOR CLAIMS IN THE SECTOR

PROPERTY - UNDERVALUATION

After the fire at the Walmart distribution center in Plainfield, Indiana, burned for more than three days, all 1,000 workers escaped unharmed.[7] The estimated $500 million property damage claim from the Walmart fire far exceeds the reported values of the location, which ranged from $41M to $79M.[7] This raises the question of how long the insurance industry can continue this pattern of undervaluation and what steps can be taken to address it.[7]

Year	Event	Country	Amount
2020	Event worker suffered brain injury at concert venue	USA	$53.7M
2021	Convenience store employee's lack of training and security resulted in escalation of robbery causing traumatic injury to plaintiff	USA	$91M
2021	Owner and manager of strip mall liable for dangerous condition of property resulting in worker's injuries	USA	$12.6M
2022	Environmental cost recovery suit against developer for contamination in residential neighborhood	USA	$133.3M
2022	Woman died from cerebral aneurysm rupture in hotel room and hotel failed in investigate after call from spouse	Canada	$60.5M
2022	Negligent serving of alcohol against bar that served inebriated driver, causing fatal automobile accident	USA	$95.5M

Source: https://www.chubb.com/us-en/benchmark-report.html

GUIDANCE

BEGIN THE RENEWAL PROCESS EARLY

The **General Liability**, **Cyber**, **Excess/Umbrella** and **Property** markets are constrained and more challenging to navigate in the disciplined market. With an outcome of increasing prices across all lines of business and in every industry sector, brokers are being swamped with submissions from their insureds who want to minimize these additional costs.

PARTNER WITH INDUSTRY EXPERTS

It is important to work with your broker's industry experts who truly understand the business and the market for placing the specific risk. Collaborating with a team who can best represent your risk and partner with your operations is more important than ever during this disciplined market we are experiencing.

HIGHLIGHT CYBER SECURITY & PROACTIVE RISK MANAGEMENT

The frequency and severity of cyber claims are constantly on the rise, resulting in more underwriter scrutiny of companies' cybersecurity hygiene. **The importance of highlighting any additions in cybersecurity staffing or updated systems protocol cannot be overstated.**

ENGAGE LOSS CONTROL TEAMS

Frequent communication with your broker's loss control team is a top priority, especially when a claim arises. Engaging your loss control team in the event of a claim can help reduce the impacts to your business financially and operationally. We work with you to understand your financial goals and operational challenges so we can identify, develop and deliver Risk Control Solutions that strategically mesh with your objectives.

CONTRACT REVIEW

Our **Contract Review** teams add value to our clients' overall risk management program by making sure the indemnity language is market standard and doesn't expose our clients to unforeseen losses that may not be insurable.

MORE THAN JUST INSURANCE

Based in North America, Parker, Smith & Feek is an integrated financial services company focused on protecting the assets of its widely varied client base through insurance, risk management and wealth management solutions. As an employee-owned company, Our 2,000-plus associates are empowered to provide customized solutions for their clients' unique needs.

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MARKETS IN FOCUS CONTRIBUTORS

ALEX FULLERTON, Marketing Specialist

JEN IANELLI, Vice President, Commercial Lines Leader, Real Estate

BRIAN LEUGS, Writer

JIM LITTERER, EVP, National Real Estate Practice Director

JIM MILLAR, Account Executive, Cyber Risk Solutions

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