2022 Q3

State of the Property Market

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We are officially in the home stretch of 2022 and with three months left in the year, things are now just starting to get interesting. Up until September 28, I would have said it had been a very quiet year from a catastrophic loss standpoint, and that this lack of activity was a welcome relief for everyone. Prior to that date, insurers were enjoying calm waters and what had the makings of a very profitable year on the back of several years of sustained rate increases that helped them get their balance sheets where they needed to be.

Insureds were also enjoying a quiet year on the tail end of COVID-19 and the economic hardship that came with it. If it weren't for Hurricane Ian, I am confident we all would have had an extra glass of scotch or two around the holidays to celebrate some much-needed relief to the insurance industry. Up until Ian made landfall, we had not seen any major storm activity in the Gulf; wildfires had not been very active in the West; earthquakes remained absent; the South did not freeze; flooding and convective activity remained below average; and it would be easy to argue that minus supply chain issues, rising interest rates, soaring inflation and the war in Ukraine, the world was starting to feel normal again.

I do not mean to imply that everything has changed as of September 28, but I do think we have to put Hurricane Ian in perspective because it will have a hold-the-line effect on the prolonged firm market that we have been operating in. This means insureds will see further rate increases during the year ahead. Many clients are feeling rate increase fatigue, but the property marketplace is still moving steadily and cautiously, which is making it hard to see signs of rate relief.

As things stand today, there is an absence of new capacity in the market and, until that changes, we will see more of the same.

HURRICANE IAN'S IMPACT

It is far too early to put an exact figure on the economic impact that Hurricane Ian will have, but right now, it is projected to have an insured loss estimate that ranges between $53 billion and $74 billion, with RMS giving it a best estimate of $67 billion. If these figures hold, Ian will rank as one of the costliest hurricanes to ever make landfall.

1	**Hurricane Katrina, 2005** $65 billion ($89 billion in 2022 dollars)
2	**Hurricane Ian, 2022** TBD with an expected range of $53 billion to $74 billion
3	**Hurricane Ida, 2021** $36 billion ($36 billion in 2022 dollars)
4	**Hurricane Harvey, 2017** $30 billion ($33 billion in 2022 dollars)
5	**Hurricane Irma, 2017** $30 billion ($33 billion in 2022 dollars)

RPS RISK PLACEMENT SERVICES

When you look at that list, a few simple observations come to mind:

FACT 1

Four of the five costliest hurricanes in U.S. history all occurred within the last 7 years.

FACT 2

Frequency and severity is on the rise and the severity is the result of increased development, cost of goods and services, and changing weather patterns.

FACT 3

Carrier spending on climate change research and more advanced CAT modeling systems seems completely justifiable.

When I look at this with my insurance hat on, I see a world in which carriers will need to plan for larger CAT events, climate change, building/construction code standards, portfolio diversification and non-modeled losses. We all know weather patterns are cyclical, but if the new normal is larger storms and more frequent storm activity, then carriers are going to need to build up more cash in the kitty to be able to sustain long-term profitably.

The idea that carriers can plan for a few years of activity and then years of virtually no activity is seeming less and less likely. The top 10 costliest storms to impact the United States have taken place between 2005 and today, with the exception of Hurricane Andrew in 1992. Simply put, the last 17 years have not been easy on carriers, and I can assure you that there is not a carrier out there that is not planning for more of the same during the next 17 years.

THINGS CAN CHANGE OVERNIGHT

Prior to Hurricane Ian, the initial outlook for 2023 discussed at September's WSIA E&S conference in San Diego was that January CAT treaties were predicted to be up anywhere from 10% to 20%, and the replacement cost values clients were using were still drastically behind inflationary pressure and new construction costs throughout America. The outlook at that time seemed to imply that we were headed for another year of mid-single-digit increases for clients that perform well, while those with adverse losses or significant CAT footprints would see rates hover in the 7.5% to 15%+ range with ease.

What was encouraging about the discussions that took place at WSIA was the fact that many of the major P&C markets acknowledged that their portfolios were well positioned, and clients that had been with them for the last few renewal cycles would be treated differently than new business accounts. For the first time in a long time, markets expected there to be some flat renewals and even some decreases available to insureds with a history of profitability for the markets they partnered with.

In the aftermath of Hurricane Ian, however, the likely 2023 message is that flat renewals or decreases will be few and far between, and carriers who were expecting a profitable year may now be seeing lackluster results. It is rare that a single hurricane would have that much of an impact, but Hurricane Ian is putting a spotlight on the hospitality industry, the multifamily industry, the private flood market, and personal lines insurers.

Hurricane Ian will also have a major impact on reinsurers who were already under pressure due to stagnant conditions in the retro market. It will also put replacement costs and building codes in CAT areas under a microscope; it is my belief that we are going to see Florida rates rise significantly in the year ahead, and other CAT-exposed states will see much of the same.

WHAT'S AHEAD, SEGMENT BY SEGMENT

For the rest of 2022 and into 2023, we should note the following:

Valuations/Replacement Cost

This will remain the single biggest area of concern and focus for all major property markets. It is dominating every renewal discussion and will continue to do so. Some clients have gotten ahead of this, but carrier data (especially loss-driven data) is showing that most clients are well undervalued, and carriers have zero tolerance with clients who try to game the system by not being realistic with their valuations.

Scheduled limits and margin clauses are likely to be a lot more common in 2023, and this will create numerous issues with clients who have strict lender requirements. Many carriers will opt not to participate in programs without a margin clause or scheduled limit, which will make capacity a challenge for some of the larger real estate schedules. You will also see that, as clients look to address this, an inflationary rise in values is going to compound overall cost increases and premium spend.

As an example, if a client makes a valuation adjustment by 10% to 15% and carriers require a 7.5% increase, then the cost to the insured is going up 17.5% to 22.5% YOY versus what the carriers will view as a favorable 7.5% increase. This disconnect will continue to be an issue that many insureds will have to grapple with as part of renewal conversations with their partner markets.

Named Windstorm CAT Cover

Hurricane Ian is going to further push the market in Florida, which was already strapped for aggregate and capacity (especially in South Florida). As we move into 2023, clients will likely get to a point where the cost to buy the same limits they wanted in the past does not make fiscal sense and those that have more financial bandwidth will likely take on more risk to offset the increased costs.

I expect we will see a bit of a pullback in the Florida market with carriers continuing to trim their line size and watching accumulations in certain ZIP codes very closely. On average, we should expect tier 1 exposed accounts to see rate increases in the 7.5% to 15% range, and those numbers could be much higher for Florida customers who had claims from Hurricane Ian. In the aftermath of Harvey, Irma and Maria, clients with major CAT losses saw increases in the 25% to 35% range, and I would expect nothing less from those impacted by Ian.

Wood Frame Builders Risk

This market segment will remain a major challenge in 2023. Lead carriers and capacity can be counted on one hand, and most carriers will remain very selective on higher risk projects in urban areas.

I remember when rates in this space were in the high teens and low $0.20s, and it doesn't seem like those days are too far behind us. Today and going forward, rates for podium projects in urban areas are constantly hovering around the $0.50 to $0.60 range and can then jump to north of $1.0 annually when you have a high crime score with limited market capacity available to you.

A major fire still dominates carrier concerns in this space, but right behind that, water damage losses are making life difficult for developers and insurers—especially losses coming toward the end of a project term when an extension is needed. Security and risk mitigation costs will continue to play a major role in this space, and clients should be budgeting accordingly.

California Wildfire/Brush Zone Business

It is too early to be fully out of the woods on wildfire season, but as I write this update, all signs are pointing toward a quiet season out West. We will need several more less active years to move the market and hopefully have more capacity return to this space. As it stands, capacity is still tough to come by on single-location risks, and rates are well north of $2.0 for most clients. It is also very challenging for clients to secure limits in excess of $75 million on single-location risks, and even when you can secure additional limit, most insureds have been buying much lower loss limits based on affordability. I do believe this market is starting to stabilize, but expect to see increases next year in the 5% to 15% range.

California Earthquake/Difference in Conditions (DIC)

It is not all doom and gloom! California earthquake capacity remains one of the most stable and competitive segments within the property insurance marketplace. There is a lot of competition in the DIC world and, as a result, clients will see some decreases and flat renewals with a bit more regularity (especially those in the middle-market space).

Larger clients who purchase much larger limits will likely see low- to mid-single-digit increases as 2023 unfolds. Like every other aspect of the marketplace, valuations are starting to play a major role in DIC earthquake insurance as well, and many carriers are starting to set minimum replacement cost figures that clients need to hit in order to get renewal terms or have new markets entertain the risk.

Multifamily/Wood Frame Garden-Style Apartments

There is virtually no change to the market outlook for this segment. I wish I had better news to offer, but I have always believed in shooting straight and not sugarcoating things. Multifamily continues to be one of the fastest-growing real estate asset classes but, from an insurance standpoint, it remains one of the most high risk and, categorically, it is one of the single largest abusers for proper replacement cost values in our industry.

Many clients have made significant strides in getting their insurance to value to a healthy level, and just as many are far below where they need to be. The human element risk and the geographic CAT risk that many of these insureds deal with makes writing this business profitably a real struggle for carriers.

As a result, I expect to see clients with a five-year track record of profitably and substantial replacement cost values see increases in the mid- to high-single-digit range. Clients who have valuation and/or loss issues will likely see increases well north of 15%, and that will be on top of restrictions to T&Cs.

As 2023 kicks off, several clients are slated to be coming out of the shared limit risk purchase groups that fell apart in early 2022, which means they are likely to have their first renewal in the open market in a number of years. For these clients, expect increases to be substantial and have major adjustments to deductibles. In some cases, market adjustments could mean as much as 50% to 75% increases YOY.

Hospitality

Unfortunately for this market segment, every time there is a hurricane, these owners and operators tend to be hit severely. People love to vacation at the beach, and Hurricane Ian is going to take its toll on hospitality insureds in the path of the storm in Florida.

We have already seen several clients put in material claims from Ian, and I expect more losses to trickle in and loss figures to rise. Over the past five years, many owners and operators in this space have seen total increases north of 50% due to past hurricane activity and market conditions. As we move forward, I expect those with good losses and limited CAT wind footprints to see very stable renewals, but those with losses and/or a heavy CAT wind footprint to see increases starting at 10% to 15% and going up from there, depending on how much they were impacted by Hurricane Ian.

HOW TO HANDLE 2023

In conclusion, the last and most simple observation is that we are living in a challenging world and we will continue to have challenging times ahead. 2023 is not set in stone, and we certainly cannot predict how the rest of 2022 will unfold, but the effects of Hurricane Ian will continue to amplify the other major issues impacting the P&C insurance industry. Start renewals early and partner with the right providers. Much like the last few years, 2023 will be about setting expectations with the carriers that have partnered with your insureds and looking for common ground where everyone walks away as a winner.

RPS is always at your disposal, and we look forward to working with you to navigate the year ahead. I hope you all have a strong finish to the year, and enjoy some time around the holidays ahead with family and friends.

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