2023 US Property Market Outlook

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The US property market finds itself in turbulent times, with a number of internal and external factors affecting market dynamics and adding to the pressures being felt by all aspects of the insurance value chain.

Chief among these is a hardening market in which increasing rates are seeing premium rises north of 50% for customers in some sectors, creating problems for agents and insureds alike.

Wes Robinson, National Property President at RPS, says that the recent reinsurance renewal period at the beginning of the year had a big impact on these rates at a time when direct insurers are already facing serious cost pressures.

"The average insurance carrier that deploys catastrophe business is looking at 30% to 80% increases in its reinsurance costs," he says. "This would be tough to bear at the best of times, but with the recent pressure on underwriting results in the direct market, many insurers have no choice but to pass these increases on to their insureds."

HARDENING MARKET

But while the recent reinsurance renewal period has hit the market hard, RPS Area President David Novak says the recent hardening of rates is more an acceleration of a trend that has persisted for a number of years.

"We've been in a hardening market for four or five years now, but increases across 2023 are expected to come at an accelerated rate," he says. "This has been driven primarily by poor underwriting results, increased cost of reinsurance and shrinking of capital in the insurance marketplace.

"The capital markets now think that easier returns are to be found outside of insurance in areas that are less risky than what we have seen in the insurance industry in recent years – a sector that had previously been seen as being able to provide a stable return."

Indeed, figures from AM Best revealed that the US P&C market reported net underwriting losses of $24.3 billion over the first nine months of 2022, nearly quadrupling the total underwriting loss recorded over the same period in 2021.

This drove the market to a combined ratio of 102.8%, with an estimated seven points attributed to CAT events.

Growing underwriting losses have also been exacerbated by climate change that has led to an increase in the frequency and severity of catastrophic events such as California wildfires, flood events and even the giant freeze that hit Texas in 2021.

In fact, global economic losses from natural catastrophes were estimated to be $360 billion in 2022, with just $140 billion of these losses covered by either private or public insurance entities, according to Gallagher Re.

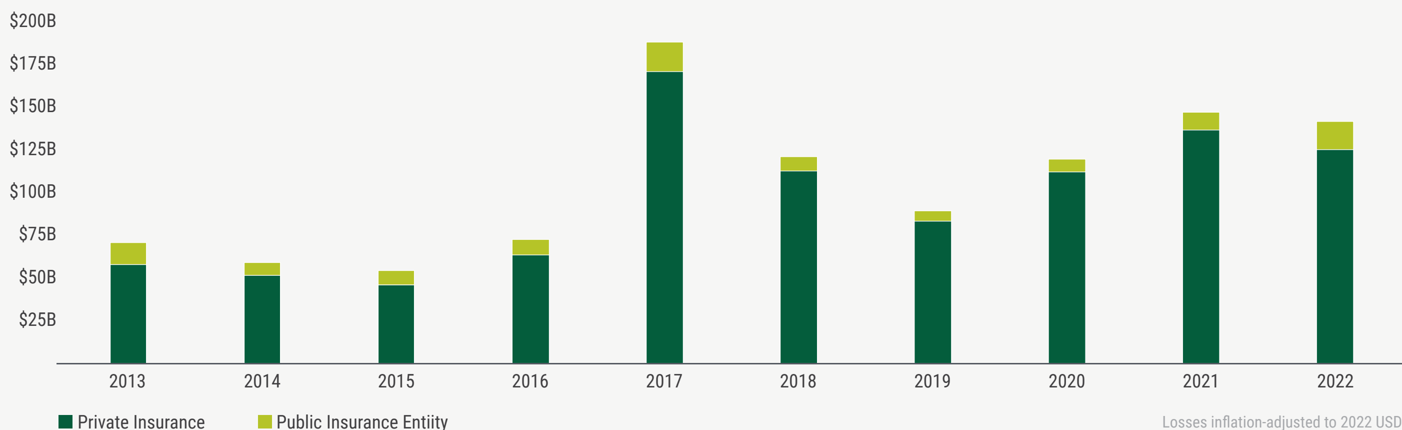

Figure 3: The last 10 years (2013-2022) of global insured losses index to today's dollars | **Source:** Gallagher Re

EVENT	DATE(S)	REGION	FATALITIES	ECONOMIC LOSS (USD)*	INSURED LOSS (USD)*
Hurricane Ian	Sept. 27–Oct. 1	US and Cuba	137	115bn	55bn
US Drought	Annual	US	N/A	21bn	9.0bn
Windstorms Dudley, Eunice, Franklin	Feb. 16–31	Europe	31	5.9bn	4.3bn
Eastern Australia Floods	Feb.–March	Oceania	22	6.8bn	4.0bn
France Drought/Subsidence	Annual	Europe	N/A	8.0bn	3.3bn
North America Winter Weather	Dec. 21–26	US and Canada	91	4.5bn	3.1bn
Japan Earthquake	March 16	Asia	3	8.5bn	2.8bn
US Severe Convective Storms	June 11–17	US	3	3.6bn	2.8bn
US Severe Convective Storms	April 10–14	US	1	2.8bn	2.3bn
US May Derecho	May 11–12	US	5	2.7bn	2.2bn
Storms Petra and Qiara	June 19–24	Europe	3	2.6bn	2.1bn

~50,000	USD 360bn	USD 140bn
Estimated Fatalities	Economic Loss	Insured Loss

*Estimates are subject to change. Insured loss totals include private and public insurance entities (such as the US National Flood Insurance Program or the USDA's RMA Crop Insurance Program).

Figure 2: Natural Catastrophe Event Summary | **Source:** Gallagher Re

The US endured a number of large-scale weather events last year, including Hurricane Ian, which is estimated to account for some $55 billion of insured losses and a total economic loss of $112 billion in the US alone.

This makes Hurricane Ian the second-costliest natural catastrophe on record regardless of peril from an insurance perspective, surpassed only by Hurricane Katrina in 2005, which resulted in nearly $100 billion in insured losses on a price-inflated basis.

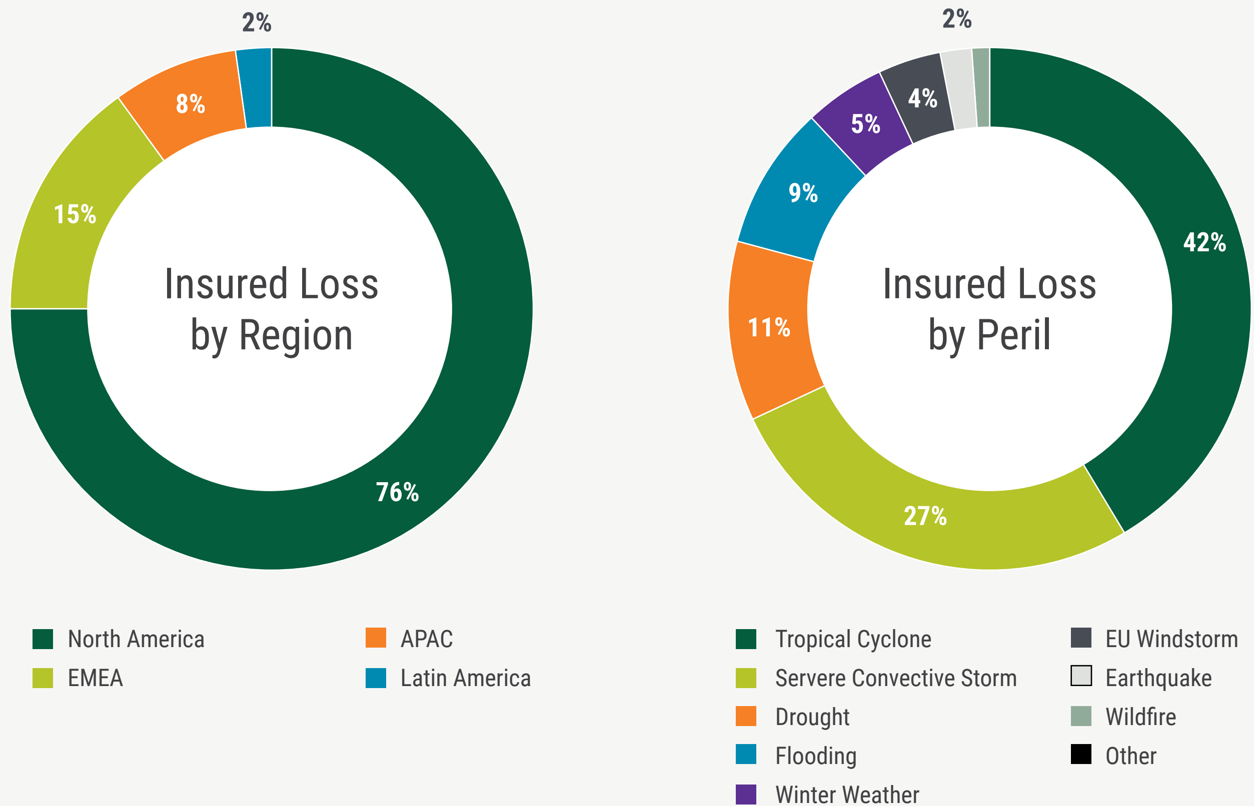

Figure 4: A regional and peril breakout of global insured losses during 2022 | **Source:** Gallagher Re

But issues outside of the property market are also affecting reinsurance rates.

"The war in Ukraine is also having an impact on the property reinsurance market," says RPS Area Executive Vice President for Property, Christa Nadler. "Even issues that are not property-related are leading to increases in the cost of property reinsurance, simply because the reinsurance market is global and wide-reaching.

"When reinsurers face these increasingly large losses across a variety of different classes and geographies, they sometimes respond by increasing rates across the board, and that is what we are seeing in the property market this year."

The market has also suffered from the rise in costs that has hit most aspects of the economy in the wake of the COVID-19 pandemic and the subsequent supply chain crisis and ongoing labor shortages.

The price of lumber, for example, reached an all-time high of almost $1,700 per 1,000 feet in May 2021, and although the price has since fallen back, price levels remain above the long-term average.[1]

The rising frequency of natural catastrophes has also led to "demand surge" issues that mean large-scale events are becoming increasingly costly from a claims perspective.

"It's not simply about the growing cost of individual losses," says Novak. "If you have a hurricane that hits the Florida Gulf Coast there's a shortage of materials to deal with, and a shortage of labor, that means everyone is looking for a builder and the same piece of lumber to rebuild. This phenomenon is known as Demand Surge.

But how is the market reacting to these difficult times apart from simply increasing rates?

CAPACITY CUT

Direct insurers have responded by reducing their appetite and limiting their capacity, with Novak warning that some carriers could reduce their capacity by as much as half over the coming year.

"Whereas a deal might've had 10 carriers involved to cover a risk last year, we are now seeing that number rise to 20 because capacity has been cut so drastically," says RPS Senior Property Broker, Nicholas Cavaness. He says that the minimum rates insurers place on policies means that many risks will also face rising costs simply as a result of having more insurers on a policy.

"A lot of this market has minimum premiums or minimum price per millions, and when you add a number of new insurers to a policy, the prices can quickly add up," he says. "Some insurers are also increasing their minimum premiums in order to reduce the number of submissions they are receiving, as they simply can't cope with the increased submissions flowing through the market at the moment."

Novak points out that this increased drain on resources at broking firms also means that deals will come together later in the renewal cycle, and that is not good news for the insured and agents.

The rising frequency of natural catastrophes has also led to "demand surge" issues that mean large-scale events are becoming increasingly costly from a claims perspective.

"The late completion of deals will be stressful for agents, and it will also be stressful for their insureds," he says. "This means that agents could be facing some unhappy customers at a time when they are also struggling to find capacity at any price, let alone at a level comparable to previous years."

Insurers are also putting additional pressure on valuations, requiring their policyholders to update the value of their portfolio for rising inflation and the increased cost of construction.

"The market is putting a lot more emphasis on proper valuations on their property portfolios," Cavaness says. "Much of this comes from adjusted claims being higher than anticipated based on the bound valuations which have often proved to be too low. This has then led to a large number of outsized losses that have hit underwriting results, and the market is now trying to readjust."

And Nadler says the issue of rising valuations has been compounded by complacency from the insurance market on this issue over recent years.

Insurers are also putting additional pressure on valuations, requiring their policyholders to update the value of their portfolio for rising inflation and the increased cost of construction.

"You can look back across some accounts and see that valuations haven't changed in the last eight to 10 years," she says. "You then have insurers in a situation where they need to get a higher rate due to increased costs, such as reinsurance etc., and they're asking for valuation increases, as well.

"When you combine the two, this can be a hefty year-over-year premium increase for an insured."

Nadler says that many insurers are also using conversations around valuations as a negotiating tool to move away from blanket limits for a policy to more restrictive scheduled limits that reduce the ability for insureds to claim for loss events across multiple locations in one single claim.

"The insurers are saying that if an insured is confident in their valuations then they should be comfortable moving to scheduled limits because their values are adequate for the exposure," she says. "Conversely, we have agents saying that if we increase our valuations then we should be able to stick with blanket limits—it's a bit of a double-edged sword really."

Either way, there has been a widespread move to these scheduled limits across the property market, as well as tighter wordings aimed at reducing the exposure facing insurers.

"Insurers have faced unanticipated—and likely un-rated for—losses lately, and they are responding by adding sublimits, reducing sublimits and tightening up coverage language," Nadler says. "We've seen this a lot when it comes to things like limits for miscellaneous unnamed locations, and even civil commotion or riot events."

Insurers are also using conversations around valuations as a negotiating tool to move away from blanket limits for a policy.

Cavaness agrees, and says that insurers "aren't giving the farm away anymore" when it comes to what is covered by a policy, with more exclusions being introduced to policies in order to limit exposure.

"This adds another layer of complexity for the agents when they are arranging a policy, because they need to be a lot more aware of what is and isn't covered under these tighter policy wordings," he says. "While some of these exclusions may not seem to be a big issue for many of the risks being placed, there could in fact be a sizable level of exposure being excluded for certain segments of the market.

"Agents need to therefore talk to their insureds where cover is being limited and ascertain if, in fact, this is resulting in an increased risk and whether alternative cover needs to be arranged to fully cover the risk."

MID-MARKET TROUBLES

The reduction in capacity across the property market has also hit the MGA sector with similar challenges, which has led to greater than average rate increases for middle market business.

This is because mid-market business has traditionally been well-served by the MGA model, with such firms able to write complex risks under one policy despite involving a number of different capacity providers, making it a much easier—and more affordable—approach for agents and insureds alike.

The price of transferring risk now is so expensive that insureds are going to have to ask themselves how much risk they can tolerate holding on to their balance sheets.

But Robinson says that the withdrawal of capacity from the property market has led to increased costs for these MGAs, which are finding it much harder to find the capacity they need to place these mid-market risks.

This in turn shifts these risks back out into the open market, no longer having the benefit of the great mouse trap these MGAs provided. "The cover is less affordable for this market segment, leading to them facing some difficult choices," Robinson says.

And this choice is essentially between paying the increased premiums they are faced with or increasing the amount of risk they retain on their own balance sheet—something that is also being felt across other segments of the market.

"The price of transferring risk now is so expensive that insureds are going to have to ask themselves how much risk they can tolerate holding on to their balance sheets," Robinson says. "But there are philosophical differences amongst insureds when it comes to risk management, risk tolerance, risk financing and also risk avoidance, so there is a lot to consider when coming up with the right placement strategy."

The manufacturing sector is another area of the market that is facing additional pressures compared to the wider property insurance market.

"The manufacturing sector is coming under increased scrutiny from insurers, and that is something that we hadn't seen five or 10 years ago," Nadler says.

She points out that where risk management recommendations from previous years may have been advisory measures from an insurer, they are now being mandated for cover to be accepted.

"The market has gotten to a point where they are saying 'enough is enough' and they are no longer willing to accept the increased risk associated with not complying with recommendations," she says. "They are now feeling that the probable maximum loss has simply gotten too high, and the insured either has to comply with the recommendations or face either an increase in their cost of cover or a significant reduction in the capacity available."

But Novak says that companies who invest in their risk resilience, including new properties that are being built to withstand the growing threat of natural catastrophes, could benefit from lower rates compared to other areas of the market.

"There are some insureds that take their risk management more seriously than others, but going forward there will have to be a lot more invested in risk management," he says. "And for those companies that do see themselves as best-in-class when it comes to managing their risks, they will have to find a way to demonstrate that to their insurers."

DIFFICULT CONVERSATIONS

For agents, the challenges facing the market mean that conversations around risk placement strategies are going to get much more difficult, but that doesn't mean they should be shied away from.

"These conversations need to be started early—as early as possible really—because renewals are becoming a much more complicated process," Robinson says. "Insureds need to be made aware that they will be facing increased premiums at renewal and they could be quite large in some cases."

"They need to be educated about the reasons for these increases, but most importantly they need to be made aware of what to expect so they can plan accordingly."

"Bad news late is always worse than bad news early," he adds.

Novak agrees and says that expectations must be set early on in order to avoid any surprises.

"Agents need to speak to their insureds early and provide them feedback about where the market is and set realistic expectations about what their coverage might look like and what it could cost," he says. "It is going to be a difficult year for the property market—particularly the first six months—so good communication about what's to come and managing those expectations is key."

For Nadler, it is also about knowing your market and being able to articulate the reasons behind increasing premiums.

"I've always been somebody that firmly believes the more data we can put in front of people the better," she says. "It is really important to be able to give clients appraisals or cost of construction scenarios that show precisely why an insurer has insisted on an increased valuation of a property portfolio, for example.

Agents and wholesalers alike need to move beyond fulfilling a transactional role and instead enter into meaningful partnerships with their insureds.

"You need to be able to give honest examples and case studies that bring the situation to life, because it is then much easier to explain the state of the market and help them understand why everyone is facing these pressures."

Ultimately, Cavaness says that agents and wholesalers alike need to move beyond fulfilling a transactional role and instead enter into meaningful partnerships with their insureds to provide them with the advice they need.

"The market is going through a difficult period at the moment and agents need to be aware of that," he says. "Here at RPS, we firmly believe brokers are there to educate their customers and ensure that they are fully aware of the risks they are facing and how that can be mitigated against.

"It is very much about being a trusted partner rather than just selling an insurance policy."

CONTRIBUTORS

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[1]Lumber rate stats: https://tradingeconomics.com/commodity/lumber

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