State of the Property Market

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I hope you all had an exceptional Fourth of July and took a few moments to celebrate American independence. Compared to other parts of the world, the US is still in its infancy, and while not perfect, it's an amazing place that most people reading this article get to call home. For me, the Fourth of July is about celebrating all the great freedoms this country provides while being with family and friends. It's also a time when I do my best to make sure I don't start any wildfires while launching fireworks for my kids, and thankfully, this year was a success.

It's simply amazing to me that we're officially through the first half of 2023. I'm amazed by a couple things: 1. The first half of the year went by in the blink of an eye; and 2. We seem to have survived what has easily been the most challenging property insurance environment anyone has seen. A colleague said that the best analogy is that 2023 is to property insurance what 2008 was to banking. In speaking with several peers at an industry event last week, we all expect that it will still be some time before the market fully corrects itself.

WHY THE PROPERTY MARKET IS SO CHALLENGING

Several reasons explain why this cycle not only has lasted as long as it has, but also seems to have accelerated like a freight train headed down a steep hill with no brakes. To list them all would put everyone reading this article to sleep, so the most appropriate explanation is tied to capital and the concept of return on capital.

Simply put, capital is the lifeline for just about every business and every industry. In the insurance world, capital is the resource that pays the claims and allows reinsurers to support the carriers that write the business that protects our clients. When that capital stops yielding enough returns to sustain the business, the capital becomes more expensive, and capital available to the marketplace shrinks. This situation creates a bit of a supply-and-demand issue for the insurance industry and raises the cost of coverage, because the demand (limits needed on a macro level) exceeds the supply (capacity needed to adequately cover customers at a sustainable price).

After several years of lackluster results for major property insurance carriers, the capital available to markets shrank, because it went to other industries and market segments that promised less risk and better returns. This problem was compounded by surging inflation during the past year and a half. The remaining capital became a lot more expensive, and as a result, the cost structure for carriers to deploy capacity went up significantly. This increase required them to cut back their exposure and charge more for what they could offer.

I have no doubt that carriers will stand to make significant profits this year, barring any major storms or unforeseen events. It would be hard not to be profitable. I also have no doubt that, with corrections reinsurers and carriers made, they are adequately prepared to weather hurricane season and other catastrophic (CAT) losses and still make a significant profit, which should attract capital back to the property insurance market.

We're seeing signs of this attraction happening, but the capital is coming in slowly and is coming in disciplined.

It's also requiring certain levels of return that will prohibit the market from shifting in the immediate future. What we hope for—and what I predict we can count on—is that the severity of the adverse corrections clients are feeling this year goes away as we fast-forward the clocks to 2024, and some level of stability returns to the market.

If you're an insurance buyer, I'm sure it's hard to keep a level head about the outcome of your renewal—but I can assure you that every underwriting company I routinely work with is overloaded with business and is doing the best it can to provide solutions that will satisfy shareholders and support good customers that have been with them for multiple renewal cycles. I can also assure you that every excess and surplus (E&S) and retail broker in the industry is looking for ways to be creative, give clients options and find ways for customers to affordably transfer risk, allowing them to focus on running their businesses. Nothing is easy on any side of the insurance transaction in the current market.

2023, A YEAR OF PROPERTY INSURANCE CURVE BALLS

2023 thus far has been a year of curve balls, and I know many of us have had to deliver tough news day after day. While nothing is fun about that, what's exciting is getting to work through challenges that hopefully put clients in a more stable position going forward. RPS is proud to meet these challenges head-on, day in and day out, and do what we can for our customers.

As always, I would like to revisit and highlight a few themes that will drive the latter half of 2023 and beyond. It's important to drill down on a few segments that carriers are hypersensitive about, and clients need to give these topics fair consideration when positioning their renewal.

VALUATION ISSUES/INSURANCE TO VALUE

The issue of insurance to value (ITV) isn't going away anytime soon, and I'm sure will be discussed for years to come. Many industry professionals and underwriting companies believe we're years away from a full correction, when the vast majority of clients properly report their exposure base in a way that allows carriers to adequately underwrite and price the risk. Many markets we trade with think this issue will continue to make the market challenging. Why? Because a fair amount of clients will need to continue to raise their values year after year to eventually have an adequate replacement cost per square foot reported on their properties.

As a result, we continue to see fewer programs with blanket limits, and many carriers are adopting strict new business guidelines on ITV. This issue will take years to fully correct itself, and we may never reach a point where valuations aren't a major talking point.

Certainly, in today's economy, with inflation still being an issue for everyone, ITV remains one of the top items carriers will drill down on. For clients, I encourage you to stay ahead of ITV and do what you can to demonstrate to the markets that the replacement costs you bring are serious estimates of the cost of rebuilding after a loss.

NAMED WINDSTORM (NWS) CAT AGGREGATE IN FLORIDA AND TIER 1 WIND

As we discussed in last quarter's update, CAT capacity in Florida, Louisiana and coastal Texas is a precious commodity. CAT hurricane capacity anywhere is precious, but in these three states, underwriters have become increasingly selective. Throughout the entire first half of the year, rate increases have easily been up from 25% to 65% for quality accounts without adverse loss experience. Accounts with geographic diversification have seen increases on the lower end of this range, and clients with single-state CAT exposure are on the higher end.

Many clients have opted to buy less limit to offset increased costs, and several carriers have more or less tapped out on writing new business in these states until they get a better sense of how the wind will blow during this year's hurricane season. The clients that have been hardest hit are the middle-market ($300 million and under) real estate clients that are 100% Florida, Louisiana or Texas. Some clients have seen massive changes to their programs, and many have seen rate increases well north of 50%-plus. Many ground-up rates are pushing north of $1.50, depending on geography and individual risk characteristics.

CAT AGGREGATE FOR EARTHQUAKE

The earthquake (EQ) market always has moved a bit behind the CAT wind market and was usually more of a buyers' market. That changed in the second quarter of 2023, as carriers struggled with the rising cost of EQ capacity. Many of the big names have increased minimum premiums on a price-per-million basis and have cut limits.

One of the largest managing general agents (MGAs) in the EQ market has struggled with the mega accounts ($1 billion-plus schedules) and has had to significantly

increase rate on many of those programs. That MGA has also seen a reduction in capacity, which is driving the market because there aren't enough carriers out there to fill the void. As a result, increases are pushing 25%-plus and averaging much like the broader market, which is hovering around 25% to 35%. We've seen several accounts increase 100%-plus when a major correction was needed and a significant amount of capacity had to be replaced.

What's unique about the EQ market is that for many clients, it's a voluntary cover and one that lenders routinely waive, so most clients are buying less or dropping the coverage altogether if they can't make the math work for their respective purchasing budgets.

HOSPITALITY AND MULTIFAMILY CHALLENGES

No single asset class isn't feeling the frustrations of today's market. As always, diverse schedules and large schedules tend to leverage better economies of scale and consistently outperform the market average. CAT-driven hospitality schedules are seeing increasing challenges, but many of the resort hotel brands are also seeing record profits, so financially they're likely to keep up with increased insurance costs a bit better.

Multifamily continues to be a real struggle, and many of the big writers have instituted new business guidelines around ITV and year-of-construction minimums that will add fuel to the fire. Best-in-class multifamily clients will be lucky to see increases below 25% and are likely to increase closer to 35% on average. Many that have been trending their replacement cost valuations will still see their programs transition from full blanket to a combination of blanket and margin clause limitations on the reported replacement costs. The hard part for apartment owner-operators is that they aren't seeing rental income increase 35%, so the increased deductible retentions they're forced to take and the increased insurance rates they pay go straight to their balance sheets.

LOOKING AHEAD

It's not all doom and gloom. Carriers are doing what they need to do this year to put themselves in a healthy and stable position. Trimming aggregate and shrinking per-risk-line size will help carriers if the wind season is above average and active. The market should continue to stabilize as we finish off 2023, and we should see the market stabilize even further in 2024, barring any major CAT events.

In the last month alone, I've had three calls with various product line leaders with some major carriers who wanted to discuss where we think new capital and products can be best used in the market. These conversations are a clear sign that things will get a bit better, and buyers should start to see a little relief as we get into 2024.

Now, I know you're saying "it can't get any worse," and you're probably right. A lot of people have said it a million times, but Joseph P. Kennedy Sr. and Knute Rockne seem to get the most credit for the best advice I can offer at this point in the market: "When the going gets tough, the tough get going."

I'm a firm believer in making it my personal mission to outperform the industry standard/average, and I know many of my RPS colleagues feel the same way. I wish you all the best in the second half of the year and hope you can continue to find success as you navigate these challenging times.

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