2021 U.S. Property Market Outlook

Helping you come through for your clients

RISK PLACEMENT SERVICES

The rate increases and capacity restrictions that distinguished the U.S. property market throughout 2020 were a harbinger of things to come.

Price increases on property insurance will continue in 2021 as we bid adieu to a year marked by a pandemic and its economic fallout, coupled with record-setting catastrophe losses.

Global insured losses attributable to natural catastrophes and man-made disasters totaled $83 billion in 2020, making it the fifth-costliest year for the industry since 1970, according to the Swiss Re Institute.

For 2021, the reinsurance industry is applying more rate pressure and terms/conditions restrictions than in previous treaty renewals. That market has been pressured by social inflation—rising costs of insurance claims due to plaintiff-friendly legal decisions and larger jury awards—growing wildfire exposures, seemingly more frequent and severe catastrophe losses, and diminishing returns on investment.

Reinsurers are passing these costs on to insurers, which were paying rate hikes upwards of 10% to 15% to renew their treaties at year-end 2020. They also are requiring that insurers exercise more underwriting discipline and have exerted a good amount of energy getting specific language locked down to eliminate any gray areas, like what has emanated from the recent COVID-19 claims.

"Though the reinsurance industry was disappointed in the amount of rate they received at this year-end renewal season relative to expectations, they will still play a larger role in rates, capacity and terms as carriers continue to improve their book composition and move toward the use of 'technical pricing'. Although the rate environment has much improved for them, the losses have not let up, so many carriers are still not making money," observed Wes Robinson, president of National Property Brokerage at Risk Placement Services (RPS).

For example, while the Midwest has historically experienced very low property rates compared to the coasts, recent losses from tornadoes and convective windstorms have exceeded underwriters' expectations, leading to double-digit rate increases and restrictions on capacity.

Because regulators limit rate hike requests submitted by admitted property insurers, many are withdrawing from our nation's midsection as their reinsurers decline to renew their treaties after being hammered by losses.

While the excess and surplus (E&S) market is here to step in and cover most of these risks, pricing is significantly higher than admitted insurance buyers may be used to.

Fortunately, more ILS capacity is trickling into the E&S market as investors see profit potential in the higher premiums that are charged.

But even E&S insurers are limiting their deployment of this new capacity, requiring many buyers to stack multiple layers to obtain adequate coverage. In some cases, these buyers are electing to buy less coverage overall to stay within their budgets.

WHAT TO EXPECT IN THE PROPERTY MARKET IN THE FIRST HALF OF 2021

- Every commercial property insurance buyer will feel the effect of a firming market
- Reinsurance will play a larger part in pricing and terms than in years past
- Rate increases in the high-single digits to 15% range on clean accounts, higher on accounts with losses
- Catastrophe deductibles converted from flat dollar amounts to percentages, and percentages increasing from 2% to as high as 5% in some areas
- Multiple insurers needed to assemble higher excess coverage limits
- New communicable disease and riot exclusions being introduced
- More restrictions on time element, ingress/egress business interruption (BI) cover
- Builder's risk extensions moving into E&S market
- Enhanced scrutiny of hospitality industry accounts

U.S. SURPLUS LINES DIRECT PREMIUMS WRITTEN ($ MILLIONS)

	Total P/C Industry		Total Surplus Lines	
Year	DPW	Annual % Change	DPW	Annual % Change
2013	545,760	4.3	37,719	8.4
2014	570,187	4.5	40,243	6.7
2015	591,186	3.7	41,259	2.5
2016	612,906	3.7	42,425	2.8
2017	642,127	4.8	44,879	5.8
2018	678,029	5.6	49,890	11.2
2019	712,194	5	55,485	11.2

ROLE OF REINSURANCE

In the first half of 2020, reinsurers were hit by $12 billion in insurance and investment losses stemming from COVID-19. In addition to the pandemic, U.S. catastrophe losses in 2020 were on track to surpass those of 2017, the last record year with over $105.7 billion in insured CAT losses.

As a result, the top 20 reinsurers' aggregate catastrophe budget and earnings buffer dropped from approximately $32 billion to $14 billion, according to Standard & Poor's (S&P), which revised its 2020 P/C combined ratio expectation for the top 20 global reinsurers to 103%–108%.

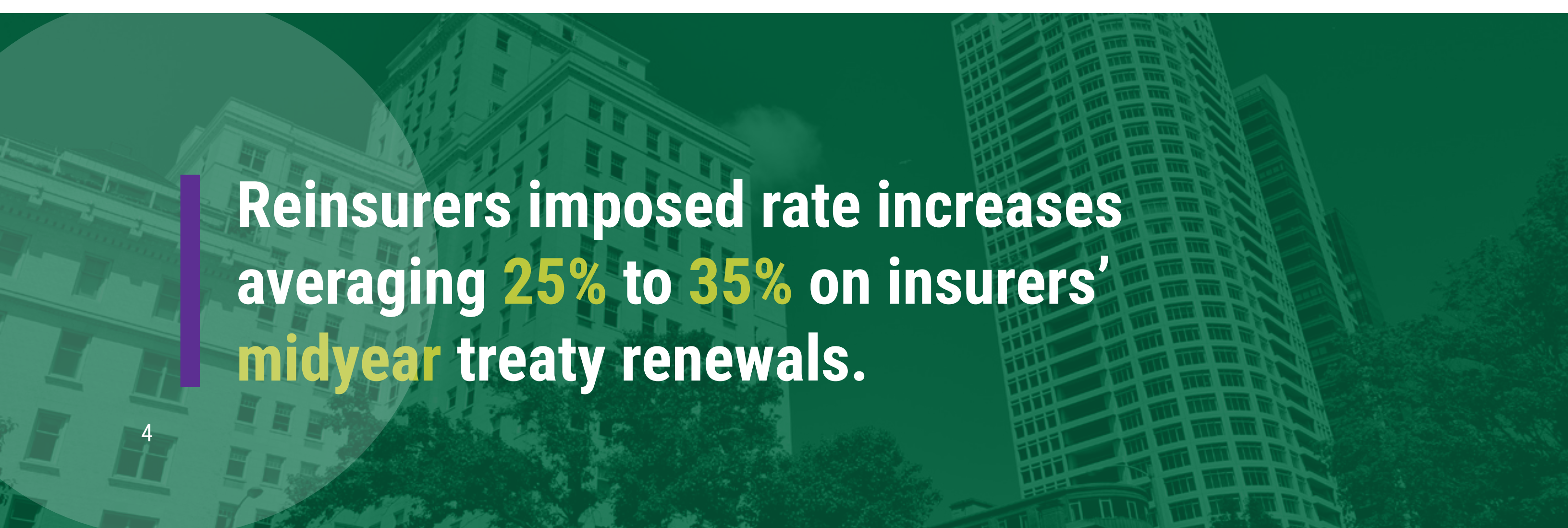
Faced with higher-than-expected losses, constraints on capital and higher retrocession costs, reinsurers imposed rate increases averaging 25% to 35% on insurers' midyear treaty renewals. As mentioned, this tapered off down to 10%-15% range for year end treaty renewals.

Reinsurers also are pressuring insurers to improve their book compositions by limiting their exposures and raising premiums.

TOP 20 GLOBAL REINSURERS' COMBINED RATIO AND ROE PERFORMANCE

(%)	2015	2016	2017	2018	2019	2020F	2021F
Combined ratio	90.7	95.1	109.0	101.0	101.0	103-108	97-101
(Favorable)/unfavorable reserve developments	(6.5)	(6.0)	(4.6)	(4.7)	(1.0)	(2)-(3)	(2)-(3)
Natural catastrophe losses impact on the combined ratio	2.8	5.7	17.1	9.3	7.2	8-10	8-10
Accident-year combined ratio excluding natural catastrophe losses, COVID-19 losses, and reserve developments	94.5	95.4	96.6	96.3	94.8	92.0	91.0
COVID-19 losses impact on the combined ratio	N.A.	N.A.	N.A.	N.A.	N.A.	6-8	1-2
Return on equity	10.2	8.3	1.6	3.0	9.2	0-3	5-8
F-Forecast. N.A.-Not applicable. The top 20 global reinsurers are: Alleghany, Arch, Aspen, AXIS, China Re, Everest Re, Fairfax, Fidelis, Hannover Re, Hiscox, Lancashire, Lloyd's, Markel, Munich Re, PartnerRe, Qatar Ins., RenaissanceRe, SCOR, Sirius, and Swiss Re.							

Source: S&P Global—used with permission.



Reinsurers imposed rate increases averaging 25% to 35% on insurers' midyear treaty renewals.

Because insurance regulators place constraints on the level of rate increases imposed by admitted carriers, some insurers, unable to get rate hikes or more restrictive terms approved by regulators, have pulled out of markets hard-hit by catastrophic losses.

- S&P predicts overall reinsurance pricing will continue to firm in 2021 in response to past CAT losses and COVID-19.
- A.M. Best & Co. estimates it will take at least two years for reinsurers to recover from the combined impact of past catastrophe losses and COVID-19.

THE COVID-19 CONUNDRUM

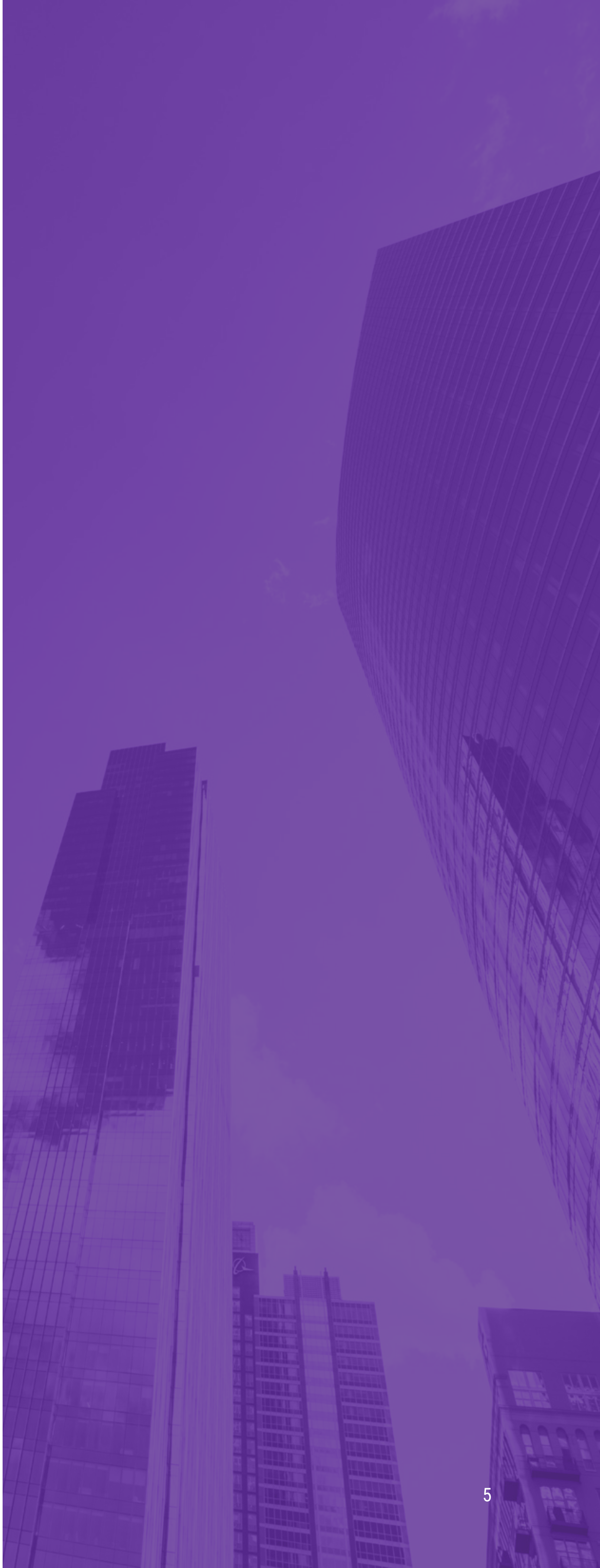
Government-ordered business closures due to COVID-19 triggered a wave of business interruption claims and related coverage lawsuits filed by affected businesses.

Though most insurers are denying these claims, maintaining that such losses are not covered unless the business sustained direct physical property damage, these legal battles continue to wend their way through the U.S. court system.

In some cases, coverage may be granted under "civil authority" clauses that provide coverage for loss of business income due to an "action of civil authority" that "prohibits access" to the insured's property.

> **COVID-19-related claims paid in other lines of business will affect the capital that both insurers and their reinsurers have available.**

Because these clauses generally require damage to property occurring within a certain proximity, insurers have begun limiting the applicable distance on new commercial property and business owner's policies. Insurers also are reducing the time element coverage period after a triggering event.



Meanwhile, COVID-19-related claims paid in other lines of business, such as event cancellation and workers' compensation, will affect the capital that both insurers and their reinsurers have available to deploy in other lines, including property.

CIVIL UNREST

Civil unrest and damage from riots protesting police brutality also heavily impacted the commercial property insurance market during 2020.

Many of the impacted businesses that were closed because of government-ordered COVID-19 lockdowns experienced physical property damage—broken windows, fire damage, looting—on top of their income losses.

Because many of these losses occurred in cities where insurers did not expect rioting to occur, such as Kenosha, Wisconsin and Minneapolis, insurers are adding exclusions for riots and civil unrest to commercial property and business owner's policies, especially on risks that include storefronts.

In some cases, insurers have been reluctant to insure properties being rebuilt after they were destroyed in the riots, labeling cities where the unrest occurred as potential "hot spots."

Some insurers have started adding coverage for riots and civil commotion to stand-alone terrorism policies, which are also being expanded to cover active shooter situations as well as nuclear, chemical, radiological and biological risks.

IMPACT OF CLIMATE CHANGE

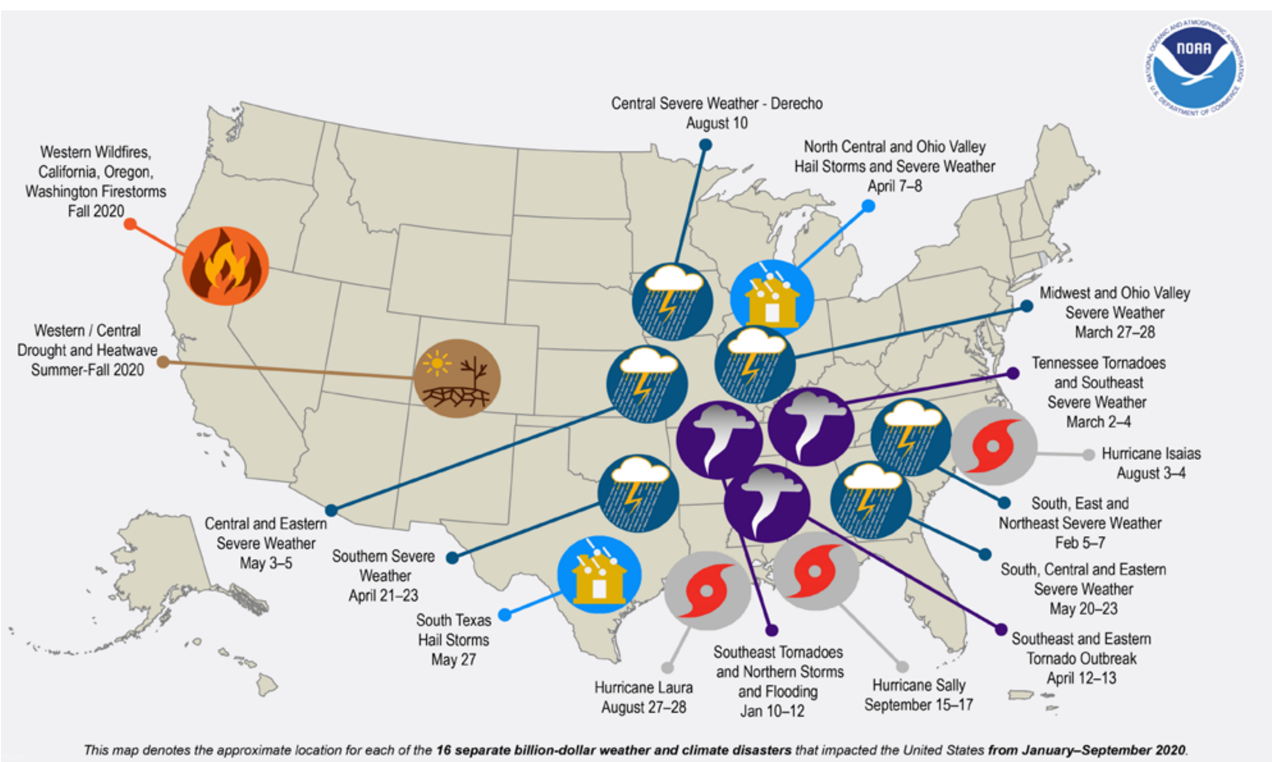
The property/casualty insurance industry's third-quarter 2020 natural catastrophe losses will be the largest since the third quarter of 2017, a year in which over $105.7 billion in insured CAT losses occurred, according to a report by Fitch Ratings.

From January through the end of September of 2020, the United States experienced 16 weather and climate disasters with losses exceeding $1 billion each, according to the National Oceanic and Atmospheric Administration (NOAA).

More than 800 wildfires in the states of California, Oregon and Washington burned close to 6 million acres, and destroyed thousands of structures, causing billions of dollars in insured claims.

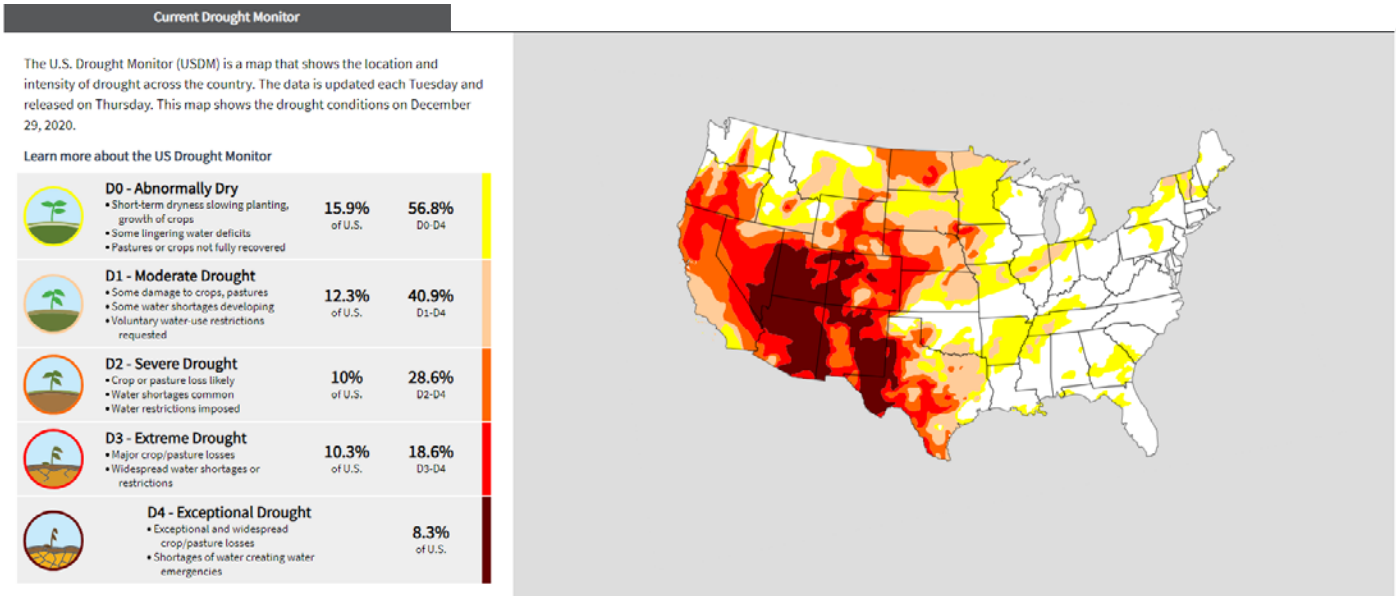
These losses, though still below the record levels of 2018 and 2017, make 2020 "one of the costliest for fires," according to the Swiss Re Institute.

U.S. 2020 BILLION-DOLLAR WEATHER AND CLIMATE DISASTERS



A map of the U.S. plotted with all 16 billion-dollar disasters experienced in 2020 through September. Map by NOAA NCEI; Climate.gov.

U.S. DROUGHT MONITOR



Map by National Integrated Drought Information System; Drought.gov.

In response, the standard property markets have pulled out of wide swaths of California, where over 4 million acres were burned, costing the insurance industry up to $8 billion, according to catastrophe modeler RMS.

The E&S market is available to cover many of these losses, although premiums are much higher than most insurance buyers are willing to pay.

"This is the first time in a long time where I've actually used the word 'uninsurable'," said James Rozzi, executive vice president of Property at RPS. That's not to say insurance coverage isn't available, but it's at a cost that may make it unaffordable. He said that one of his California accounts is "going bare because they're not going to spend $1 million to insure a $3 million building."

Insurers also experienced significant losses in states where wildfires are less common, like Oregon and Washington. Last year's record fires additionally destroyed properties in populous parts of Colorado and Idaho, racking up huge claims.

Many of these fires are attributable to climate change, which has been blamed for drought conditions intensifying throughout the Western U.S. An estimated 42.6% of the U.S. suffered from drought conditions during 2020, according to NOAA.

In addition to record fire losses, last year's hurricane season was especially active, forcing the World Meteorological Organization to adopt letters of the Greek alphabet to label storms after using up the names that had been reserved for 2020.

Of the 30 named storms, 12 made landfall in the contiguous United States, breaking the record of nine set in 1916. Hurricane Laura represented the largest single loss event, with insured losses estimated at $11 billion to $15 billion.

Climate change also has been blamed for the shifting of the so-called "Tornado Alley," contributing to an increase in the number of tornadoes occurring in the mid-South region.

April 2020 was the second-most active April for tornadoes on record, with the National Weather Service logging 351 tornadoes that month alone.

An outbreak of over 150 twisters that began on Easter Sunday ravaged parts of the South and Southeast. 2020 also proved to be the deadliest year for tornadoes since 2011, with 73 fatalities. Forty of those deaths occurred in April.

Because rebuilding costs are often higher due to increased demand for materials following a natural catastrophe, as well as increased use of technology in building properties, some claims have been piercing excess coverage layers, taking excess carriers by surprise.

In most cases, CAT models indicated that excess layers shouldn't have been hit. As a result, underwriters at many excess carriers are re-rating policies internally, pricing the risks as much as 40% higher than what is submitted or what their models estimate.

"Insurance-to-value is a very, very hot topic, and it will be again for 2021. It has been challenging placing excess coverage without solid valuations," said Stephen Adair, senior vice president at RPS.

When preparing any property insurance submissions, agents and brokers should make sure their clients provide recent appraisals. Otherwise, underwriters may limit recovery amounts based on their models' replacement cost projections.

Documenting loss control measures to demonstrate that property owners are committed to protecting their assets could also improve their ability to secure coverage at a more reasonable price.

IMPACT ON INDUSTRY SECTORS

Habitational Real Estate

Habitational real estate continues to be a difficult class of business to place, even in the E&S market.

While some habitational accounts have created insurance programs for tenants as a revenue source to help offset their own property rate increases, most are still experiencing double-digit premium hikes.

"I had a customer that experienced a $45 million Hurricane Laura loss in Louisiana in September. Mostly wind and roof damage. They are going to see a 35% rate increase with additional retention requests: higher deductibles, windstorm deductibles," said David Novak, area president at RPS.

Quality information continues to become more and more vital due to the fact that all carriers now rely heavily on model outputs to assist with their decision-making.

Therefore, providing more detailed information, such as age of roofs, electrical/plumbing/HVAC updates and other secondary modifiers, can improve the results that RMS and AIR provide.

The best advice we can offer hospitality customers at this time is to convey as much information as possible about what operations have ceased at their respective properties and what operations are ongoing.

Hospitality

Property rates on hospitality accounts grew 20% last year and are likely to jump at least that much again in 2021, but COVID-19 is making it harder for these businesses to absorb this added cost.

Underwriters also are asking a lot more questions about occupancy rates and other ways that hotels and motels are being used since the pandemic disrupted most American's travel plans.

When COVID-19 cases first spiked in the Spring of 2020, some hotel properties were converted into temporary housing for medical staff or COVID-19 patients requiring quarantine.

But many other properties remained vacant, which changes the exposure. For example, if no one inhabits a hotel room for an extended period of time and a pipe bursts, considerable water damage could occur before it is discovered.

Buyers should disclose how properties are being maintained, protected, or in some cases, improved, from risk quality standpoint, while hospitality occupancy rates are at historic lows.

"The best advice we can offer hospitality customers at this time is to convey as much information as possible about what operations have ceased at their respective properties and what operations are ongoing. We continue to spend a lot of time working with clients on accurately measuring their business income for the last 12 months and projecting that forward as the COVID-19 pandemic evolves," said Rozzi.

"The key for hospitality clients is to make sure they aren't overinsuring their business income and revenue figures as part of their insurance program renewals, because if they have not adjusted figures as a result of the pandemic, then they are probably overpaying for coverage they would never get in an actual loss-sustained claim scenario," he advised.

Schools and Public Entities

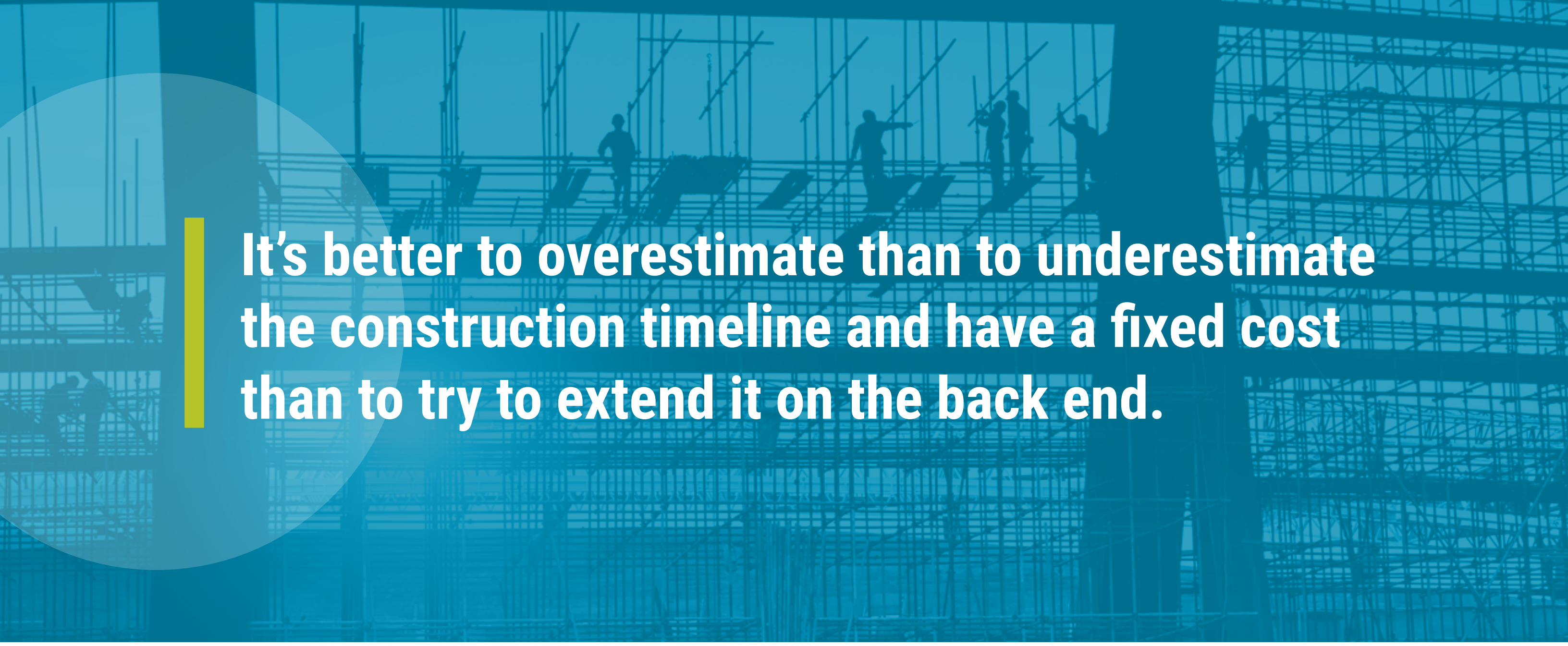
With declines in sales tax revenue attributable to COVID-19-related business closures, many public entities are grappling with budget cuts that will affect how much property insurance they can afford to buy.

At the same time, rate increases are ranging from the high single digits to more than 15% depending on CAT exposure and loss experience.

But as public entities' coffers are depleted, their property exposures are increasing.

For example, since many school districts' bus fleets remain parked because of school closures, they are more vulnerable to hail damage, because they are concentrated in a single area.

"I was on a call with a large municipality, and they made it clear that they needed an option for a flat-dollar spend. That will mean we'll either have to increase the attachment point, or we'll have to cut limits off the top or do a quota share program," said Raul "Rep" Plasencia, executive vice president of Property Brokerage at RPS.



"There is no way to get coverage for CAT wind or all other perils without a rate increase. But we can get them a flat spend by giving up 20%–30% of wind limits or raising their deductibles by 10%–20%. We are all getting creative to get the insureds the coverage they need."

Builder's Risk

Because of COVID-19-related delays and shutdowns, many building project owners are seeking extensions on their builder's risk insurance.

While construction delays are common, government-ordered shutdowns have increased both the frequency and duration of many of these delays, requiring additional coverage extensions.

Since many admitted insurers are unwilling to provide more than one extension, many of these risks are turning to the E&S market for coverage.

"We have a current project where if any of the workers on a site are diagnosed with COVID-19, the whole construction site is shut down for three days, no matter what," observed Chelsea Bergen, area assistant vice president at RPS.

"That's an unforeseen delay. Even when they ask for a coverage extension, it's hard to know how long they will need it. But most builder's risk carriers are only allowing one extension. As a result, the nice, new construction that we usually don't see in the E&S market is coming to us for extensions."

Bergen also is advising agents to negotiate longer construction terms on builder's risk policies than they may have in the past. "It's better to overestimate than to underestimate the construction timeline and have a fixed cost than to try to extend it on the back end," she said.

Industrial & Processing

Many accounts that fall into this category have historically safely and comfortably been insured by the standard market. As some standard carriers make decisions to line-down or outright non-renew specific accounts or classes of business, the E&S market has seen a deluge of these types of accounts come its way.

From food processing, plastics, molten metal exposures and recycling, the E&S market has been doing double-time finding creative risk-transfer solutions.

The key differences in this industry segment between the standard market and the E&S market is that the typical E&S carrier doesn't have a robust loss control department to assess the risk; doesn't have rate structures and reinsurance arrangements for this occupancy; and, generally has a very small capacity line for these occupancies.

Moreover, many of these accounts have multinational exposures, which is a non-starter for many E&S carriers.

For example, a recent food-related account had been enjoying $500 million in limits and a six-digit premium in the standard market. After receiving a non-renewal notice from the carrier, the account it was widely marketed, and the end result was about a fivefold increase in rate for $150 million in limits.

A common thread for all industrial and processing accounts is that carriers are examining the degree to which they have complied with engineering/loss control recommendations. For years, the industry has allowed recommendations to be deferred. But, carriers are no longer letting them slide.

"Those current with compliance and willing to partner with the carriers are seeing noticeably better treatment in their placements," said Robinson.

Bringing these and other manufacturing accounts to the E&S market could cause sticker shock for some buyers, as the rates are considerably higher than in the admitted market.

There is capacity in the marketplace; it's just a matter of whether buyers are willing to pay for it. But businesses that can demonstrate they are emphasizing loss control will get better pricing and terms from E&S underwriters.

> **Buyers will become more accustomed to layering coverage purchased from several different insurers.**

LOOKING FORWARD

Since COVID-19 entered the picture, commercial insurance placements have been, to say the least, different.

Instead of visiting underwriters in their high-rise office buildings, nearly everyone is working remotely using Zoom, Webex, or some other online networking platform. Documents are being sent via secure email and signed electronically. Even inspections are taking place using smartphones.

Although a vaccine has been approved by the FDA and distribution has begun, it will take time for Americans to acquire the "herd immunity" infectious disease experts say is necessary for everyone to resume business as usual.

That means the insurance business will very likely continue to operate this way for the foreseeable future.

Given the economic constraints stemming from the pandemic, agents and brokers will have to put in extra time to identify creative solutions that match the sums their clients have available to spend.

To obtain affordable property insurance, buyers will need to evaluate their risk tolerance for increased deductibles or reduced excess coverage limits. Some buyers are already assessing how much excess coverage they really need.

Valuations will be key as underwriters calculate replacement costs, often second-guessing their catastrophe models.

This may also be a good time to assess coverages that clients do not need in their policies given the current economic situation.

This effort could alleviate carriers' concerns regarding their potential exposure to certain losses while also increasing competition from other carriers, especially if it eliminates a coverage that precluded certain carriers from insuring the risk.

Valuations will be key as underwriters calculate replacement costs, often second-guessing their catastrophe models.

Buyers also will become more accustomed to layering coverage purchased from several different insurers, as no one carrier is likely to offer up more than $25 million in limits on a single property.

In some cases, agents and brokers might want to suggest their clients enter into quota share arrangements instead of increasing deductibles or retentions if they don't feel comfortable self-insuring more of their risk. Insurers also may be willing to come down on premium if they are sharing some of the exposure with the buyer.

"We've seen a lot of changes in appetite, in available capacity and in the property market in general," said Christa Nadler, executive vice president of Property at RPS. "We've seen property accounts that last year took one or two carriers now needing four or five to get it done.

And they're going to take a rate increase of 25%. I'm currently working on a recycling account. Last year, there were three carriers. By the time we're done, there's going to be eight."

While it remains to be seen whether COVID-19 will disrupt the supply chain for building products, surge pricing almost always follows a natural catastrophe.

And if the past few years are any indication, hurricanes, tornadoes and wildfires will continue to plague the nation as climate change disrupts historic weather patterns.

Although it's pretty much a given that insurers will add communicable disease exclusions to property policies in the wake of COVID-19, it's also important to watch out for riot exclusions and restrictions on time element and mileage distance for ingress/egress coverage, especially on classes of business vulnerable to business interruption losses like dine-in restaurants and those with storefronts.

Also make sure hospitality customers disclose vacancy rates to underwriters, and ensure that any unused premises are locked, protected and monitored.

In all renewal discussions with clients, agents and brokers should clearly explain how any changes in the amount and types of risk they assume will affect their attractiveness to underwriters as well as the premium they will be charged.

Providing examples of potential claim scenarios may be especially useful in helping clients understand the financial impacts of coverage changes.

Experience and relationships still matter in today's market, maybe now more than ever. Independent agents and brokers should choose a wholesale broker with a solid track record and longtime relationships with underwriters. Seasoned wholesale brokers who have experienced the market's historical ups and downs know how to negotiate and structure placements to make them more affordable. They also have a better understanding of how to assemble a layered or quota-share program, if necessary, to obtain desired coverage limits.

"Maybe the worst is behind us," said Rozzi. "The last quarter of 2020 showed some positive signs, with new capital coming in. But if insurers can't make money, they will move their capacity."

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