State of the market for Real Estate

Gallagher

Insurance | Risk Management | Consulting

Our 2020 Real Estate market update is being produced at a time when 30% of the world's GDP is in lockdown[1], an unprecedented position severely impacting commercial activity. Covid-19 and the damage done is likely to accelerate trends that were already shaping the insurance market globally.

2019 was a challenging year for the global insurance market; increased catastrophe losses, mounting liability, continuing low interest rates, stagnant global economic growth and the growing likelihood of a global recession, all of which contributed to a hardening market.

The UK climate was no different, and the situation was compounded further in the Real Estate sector. A long standing competitive market has been forced to harden as a result of profitability being significantly affected by adverse weather conditions caused by more frequent winter storms over the last two years (underwriting profitability fell to a 10-year low in 2018 as insurers recorded a loss of GBP317m[2]), together with a sharp rise in claims since the beginning of 2018.

Furthermore, capacity has reduced in the sector following the withdrawal of Tokio Marine Kiln[3] and MS Amlin[4] from the UK company market towards the end of 2019, increasing the upward pressure further on rates.

Source

1 https://www.thetimes.co.uk/article threat-of-30-hit-to-gdp-prompts-calls-for-end-of-lockdown-85q5sxhcp

2 https://www.businesswire.com/news/home/20191112005990/en/United-Kingdom-Commercial-Property-Insurance-Market-Report

3 https://www.insurancetimes.co.uk/news/tokio-marine-kiln-to-close-uk-insurance-company/1430721.article

4 https://www.postonline.co.uk/commercial/4399766/ms-amlin-to-withdraw-from-nine-lines-of-business

As a result, we expect many of the following trends seen in Q4 of 2019 to continue well into 2020, with the impact Covid-19 hugely influencing what was already a challenging market place:

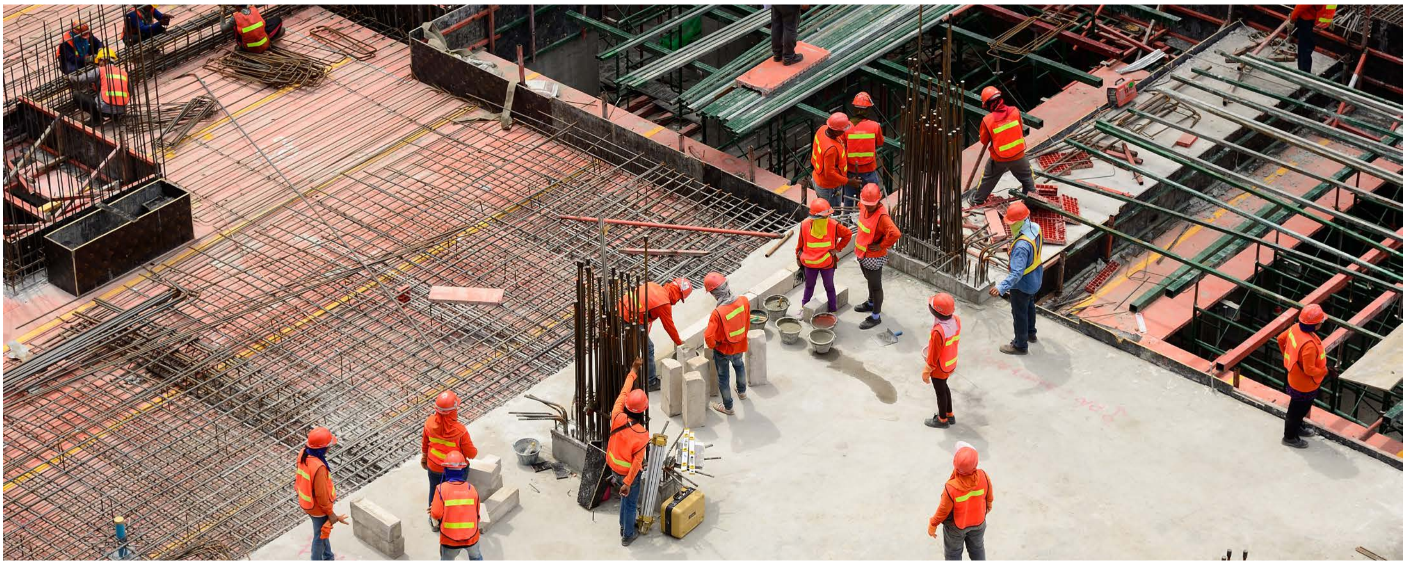
- Rating increases across all asset classes
- Greater scrutiny of underwriting information, named COPE (Construction, Occupancy, Protection and Exposure)
- A universal approach across all of the main insurance companies to start reducing commissions and bursaries, such as risk management funds, as a result of regulatory intervention and reputational risk
- Reduced capacity for catastrophe risks across Pan-European insurance programmes.

These 2020 trends are only being further exacerbated by the effects of Covid-19, with insurers being placed under a global microscope and legal wrangles looming over the industry. In addition many insurers are exposed financially in their life and non-life insurance businesses, as an investor of clients' premiums, and as an earner of fund management fees through the ownership of asset management operations. This means a turbulent year is expected to continue.

In the Real Estate sector specifically, insurers have been focusing on their existing portfolio of clients and showing less appetite to write new business. Striving to establish where claims related to Covid-19 will ultimately leave them and an urgent review of policy wordings (to establish how they might be clearer in response to this and future pandemics) means insurers find themselves juggling a significant number of priorities. The result is everything is taking longer and options for property owners are decreasing.

We believe there is still opportunity for programmes that are well risk managed, have a good claims history and where certainty can be provided around materials used within the construction of assets. However, it is unlikely that any client will be totally immune to the trends described above.

Within our Real Estate team, we believe it is imperative to work pro-actively for our clients to ensure they remain protected from changes in market conditions and unprecedented times.



Top Tips:

In spite of the tough market conditions, there are actions that you can take that will help with any negotiations with insurers:

- **Teamwork:** Work with a broker that understands what you do, is well-resourced to absorb the additional time that renewals will take, and that can leverage the insurance market regardless of which part of the cycle it is in.
- **Start Early:** Start your renewal process earlier with a clear strategy for what you want to achieve, with a contingent plan in place should difficulties arise. For acquisitions engage with your advisors at the earliest available opportunity in order to provide the most competitive terms.
- **Be Flexible:** Your broker will ask you about new structures and programme designs to ensure they're looking at all available options to secure your renewal, for example utilising the Lloyd's Terrorism market opposed to traditional methods like Pool Re (UK Government Terrorism pool).
- **COPE (Construction, Occupancy, Protection and Exposure):** Provide as much underwriting information as possible for each asset so property can be thoroughly evaluated, including a pro-active approach to good building maintenance and management.

Whilst real estate insurance is the primary line of coverage there are other classes of insurance property owners will have to procure. Below is a brief market update for some of these:

Corporate Liability

The Professional Indemnity and Directors' and Officers' (D&O) markets were the first to experience a hardening market, which will continue throughout 2020. Claims events in the US, such as securities class actions have reached historically high levels, meaning claims reserves are impacting upon the capacity and cover in the corporate liability market. As a result of this rates are likely to remain high.

Construction

For real estate owners and/or developers' looking to undertake significant works in 2020, the trends of 2019 look set to continue; being predominantly major fire and escape of water losses, commonly arising from either poorly monitored hot works or poorly installed modern pipework without adequate pressure monitoring systems in place. These losses have led to significant rating increases across the board in the Construction sector, and as with Real Estate, these increases only look to be further exacerbated by the effects of Covid-19.

In addition, capacity has reduced following the withdrawal of 12 markets, further contributing to increased premiums, and also resulting in cover limitations being applied in many instances.

Legal Indemnity

The title insurance market in 2019 was stable and competitive with the addition of new capacity, which is expected to continue for 2020 despite increased claims being reported.

Increased capacity has forced rates down generally in the legal indemnity market. 'Rights of Light' risks have seen an uplift in claims, but rates remain competitive with competition and innovation around retention levels being more of a focus. The rates on European risks remain fairly static, though with the introduction of further capacity, the rates and coverage levels are likely to improve.

Warranty & Indemnity

2019 proved to be the fifth record year in a row for the Merger and Acquisition (M&A) insurance market. More M&A insurance products such as Warranty and Indemnity (W&I) were used in 2019 than any other year.

Looking ahead, the rate of claim notifications against W&I policies is likely to increase. This is due, in part, to the Covid-19 crisis, but principally the volume and range of deals that have been and will continue to be insured. The knock on effect is already being felt during underwriting, as insurers are increasingly demanding various Covid-19 related exclusions and restricting cover for warranties that could be sensitive to Covid-19's impact.

The underwriting process is also expected to become more thorough and defensive for hard hit operating businesses in the real estate sector, such as hospitality and retail.

W&I pricing in 2020 is likely to remain the same. In the near term, although the risk profile of some businesses and properties may have increased due to Covid-19, insurers will be competing to win a smaller pool of deals. In the long term, whilst we expect to see continued competition in the M&A insurance market, we don't expect to see a continued decrease in W&I premium rates, mainly due to the growing number of claims paid out by insurers.

Would you like to talk?

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