Insurance | Risk Management | Consulting

U.S. Real Estate and Hospitality Market Update

FALL/WINTER

Introduction

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YEAR-END REVIEW WITH AN EYE TO 2022

As the world emerged from its COVID-19-induced haze, the real estate and hospitality industries saw a range of operational and profitability improvements, depending upon asset class. The big winners were industrial, single-family rental (SFR) and build to rent, as well as data centers and multifamily. Commercial offices, hospitality and malls still had headwinds, while grocery-anchored and self-storage performed well. On the other hand, insurance claims in 2021 appeared to be in the "death by a thousand cuts" category, with Winter Storm Uri now estimated to be more than $15 billion and Hurricane Ida pitching in another $44 billion, based on a September article in *Business Insurance*. The fact that Ida impacted assets from the Gulf Coast to New Jersey speaks volumes about the damage caused by flooding and the difficulty the industry has predicting the quantum of damage caused by hurricanes. What this means in English is that any dramatic rate relief that was predicted is on hold until the Q1 2022 reinsurance renewals are negotiated.

There were, however, some bright spots in a leveling of the trajectory of primary liability, umbrella and professional liability premiums. You'll find more on the specifics in this report.

The bottom line for 2022 is to invest in CapEx to protect your assets, your tenants and employees, and never cut corners when it comes to presenting true and accurate valuations. Based on recent comments from the underwriting community, those organizations who were "being clever" by underreporting values are going to have a painful renewal cycle, and no one needs a self-inflicted wound.

Management Liability

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Overall, the rate environment for management and professional liability has continued to improve in Q3 with the exception of cyber liability. Average rate increases for directors and officers liability (D&O), employment practices liability (EPL), fiduciary liability, errors and omissions liability and crime are in the range of 5%–25%, down from 25%–75% a year ago. The improvement is due to both new insurance companies entering the market and improved economic conditions as we transition out of the pandemic closures. Asset class is a main factor in determining renewal pricing.

The outperforming asset classes like industrial and SFR are seeing the best outcomes of 0%–7% increases, office is seeing 10%–15%, and retail and hospitality are in the 15%–25% premium increase range. These rates are consistent between public and private asset managers/private equity. Even though new capital is entering the market, worsening claims trends are driving increases. We are seeing increased claims activity in private asset managers/private equity stemming from increased Securities and Exchange Commission investigations and enforcement, and more activity is expected given the changes in these agencies and also in the federal courts. On the public company side, we are still seeing a high incidence of claims stemming from mergers and acquisitions, IPOs and especially special purpose acquisition companies (SPACs), which have had a huge impact on the market.

General Liability

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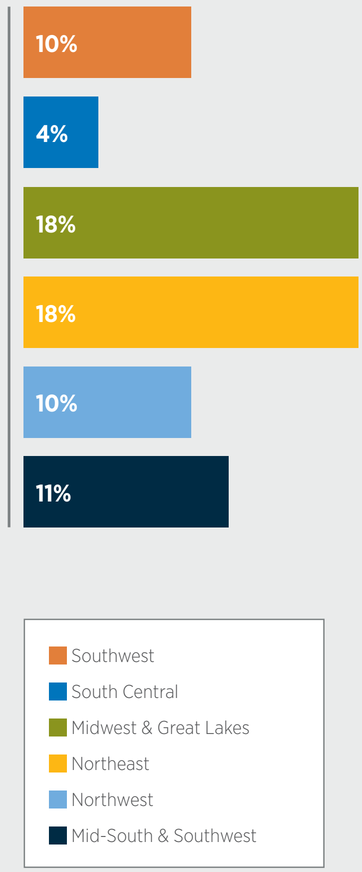
Insurance carriers are still stabilizing. While we do not expect any rate decreases, we do believe that the knee-jerk increases incurred in 2020 and 2021 will subside. We expect to see nominal rate increases of between 5%–10% on the primary lines and in the sub-20% range for umbrella—albeit for those with favorable loss history, risk control and structures. The primary 1 million option is becoming more and more obsolete—especially for those with residential exposure and/or large fleets—either owned or non-owned. For those who have taken measures to either increase retentions/deductibles and/or have inserted a buffer layer (small umbrella) in lieu of the formally traditional $25 million umbrella, we believe that the majority of frictional cost has been incurred. In addition, we have seen new carriers come into the market offering limits in excess of $25 million or $50 million, which is helping to keep the rate increases in check.

Multifamily continues to be a struggle, with carriers examining neighborhood crime scores and risk control. Many liability carriers are shying away from frame residential (aka garden-style apartments) due to the fire risk and potential loss of lives from one occurrence. All submissions should be armed with in-depth details pertaining to updates made to building construction, life safety protections, and all risk transfer utilized by the property owner and/or manager.

GENERAL LIABILITY RATE CHANGE BY REGION

Average Gallagher U.S. Change



Single-Family Homes

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Over the second half of the year, SFR portfolios saw rate increases below their multifamily peers, frequently at or below 5%. Portfolios with large year-over-year growth have realized rate decreases, as capacity from new carriers has pushed incumbents to lower their premiums in an effort to maintain the business.

As institutional investment has flowed heavily into the asset class, SFR owners continue to acquire at a fast pace while maintaining a geographically diverse footprint. The dispersion of risk and lack of concentration in any one area makes the asset class desirable to insurers, many of which are flocking to the space. As the industry has pushed for higher deductibles, attritional losses have decreased, making SFR a profitable class of business for property insurers.

With more than a decade of claims data, insurers now underwrite SFR with a strong confidence in adequate replacement cost valuations. This differs from other asset classes, which are more difficult to value and ultimately bring more underwriting challenges.

As the U.S. grapples with an undersupply of housing, build-to-rent (BTR) has also expanded quickly, bringing new rental inventory to the market. Unlike the existing stock of SFR portfolios, BTR is bringing new product to the market, but with heavier concentrations in single neighborhoods. As this segment of the industry continues to expand, insurers may see an uptick in claims excess of deductibles, as localized weather events could bring larger amounts of damage within a given community.

Hospitality

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PROPERTY

The property market continues to stabilize. For clean accounts, even catastrophe (CAT)-driven ones, rate increases are flat to up 10%. Deductibles, particularly for wind, hail and water damage, continue to increase. “Many property carriers, whether standard or E&S, are continuing to lose money but are hopeful for 2022”—According to Rich Clark, hospitality niche manager at Gallagher, accounts with poor loss history will continue to see significant increases. The London market appears to be a bit more aggressive than domestic carriers.

GENERAL LIABILITY

We are beginning to see this market stabilize and new carriers are entering the space. Many markets are pushing sexual assault and molestation (SAM) exclusions, as well as coverage restrictions for legionella. With good underwriting data, we have been able to maintain coverage. GL rates seem to be at a level where carriers feel they can make money, especially when paired with workers’ compensation. Rates are close to flat for profitable accounts. Receipts are on the way back up as recovery from COVID-19 continues.

Developer's General Liability

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Most construction casualty product lines saw gentler rate increases in Q3 2021 than those experienced in the preceding quarter. Despite the increases, owner/developer-controlled insurance coverages (GL-only owner controlled insurance program, owner's interest GL, owners protective professional indemnity) generally remained more competitive than general contractor-sponsored/ controlled alternatives.

Clients actively engaged in development projects should be keenly aware of the following:

- Labor and material shortages, as well as municipal delays in signoffs, continue to cause completion delays. Managing policy term extensions and budgeting for the corresponding additional premiums is critical.
- The exclusion of contingent general liability coverage within owner/developer operational general liability programs for significant construction projects.
- The rapid uptake of stand-alone OIGL coverage to plug the gap mentioned above.
- Excess liability capacity remains a challenge, with lead excess pricing often determining the overall cost efficiency (or inefficiency).
- Average GL-only OCIP and OCIP excess liability pricing remains stable at 1.5% to 2.0% of project hard costs for commercial projects, and potentially double that on "for-sale" residential projects.

Environmental

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The tightening of terms and conditions in the environmental insurance market signals the continuation of a firming marketplace. Insureds should expect higher deductibles and a reduction in limit capacity during the next renewal cycle.

Depending upon the risk profile of an insured and the desired environmental coverage, limit capacity can be hard to come by. A carrier who may have previously been willing to offer $25 million in limits on a particular risk, may now only be willing to offer $15 million, according to Tony Lehnen, senior vice president at Gallagher. This increased scrutiny can be predominantly attributed to an uptick in claims associated with per- and polyfluoroalkyl substances, known as PFAs, and indoor air-quality exposures related to mold and Legionella.

Gallagher's environmental specialists are constantly monitoring the policy changes being handed down by the U.S. Environmental Protection Agency under the Biden administration and the potential impacts that these changes will have on our clients.

West Coast

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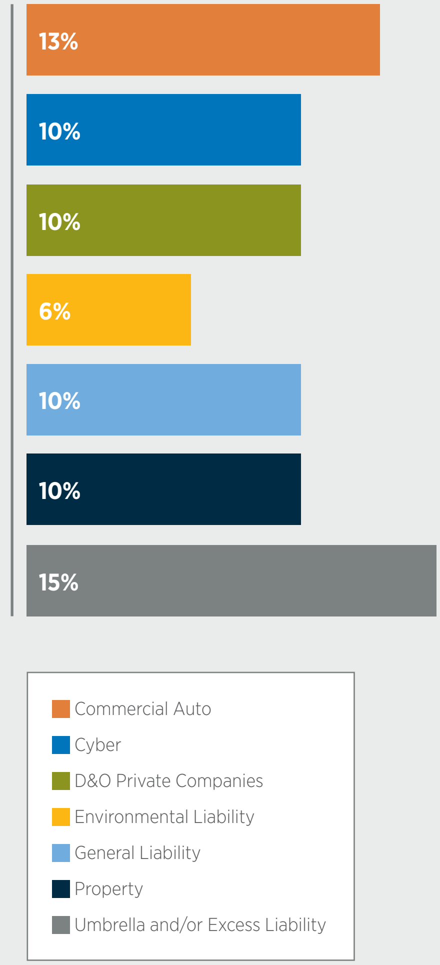
We are now in a market where an insured's specific risk profile will dictate its renewal results. Asset classes such as offices and/or insureds with excellent loss experience are seeing stable renewals. Multifamily and hospitality asset classes continue to see rate pressure and extreme underwriting scrutiny on both renewals and acquisitions.

With respect to property, the same underwriting issues exist, with a focus on building valuation, wildfire zones and information around building updates for older properties. For insureds with claims, underwriters continue to push for higher deductibles.

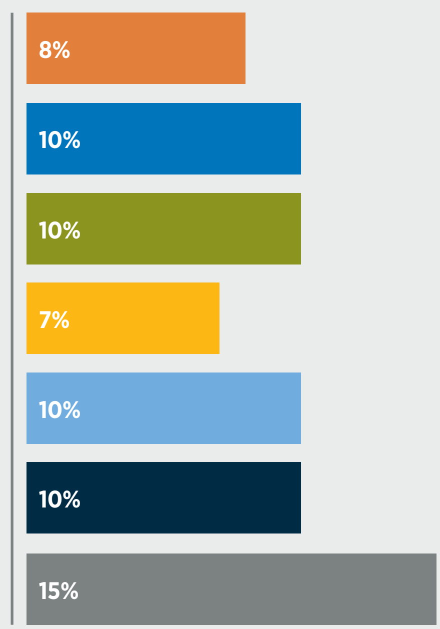
Similar to property, primary casualty has stabilized for certain asset classes, such as office, while multifamily and hospitality portfolios should brace for a multitude of challenges, including 1. volatile rate increases, 2. limited renewal options from the market, and 3. restrictive terms and conditions, such as limitations or exclusions on assault and battery, and sexual abuse and molestation .

The umbrella/excess liability space closely tracks with primary casualty. Capacity is limited for multifamily and hospitality, with rates continuing to rise. Clients in RPGs will face the same issues: reduced limits, increased rates and more restrictive terms and conditions.

NORTHWEST RATE CHANGE BY LINE OF COVERAGE
Average Gallagher U.S. Change
Justin Dove



SOUTHWEST RATE CHANGE BY LINE OF COVERAGE
Average Gallagher U.S. Change
Justin Dove



Midwest & Great Lakes

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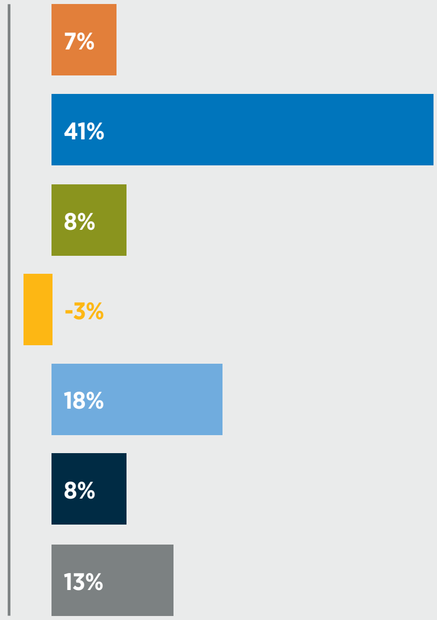
The outcomes of renewals on Midwest & Great Lakes risk continues to be highly dependent on individual or asset-specific underwriting characterisitics. Insurance carriers continue their push to gather more accurate underwriting data and are making their decisions based on a highly defined set of characteristics for the business that they want to write. On a broad basis, competition continues to creep back into the marketplace, and multistate portfolios with both Midwest and other, higher-severity geographies are starting to see plateaus in pricing where valuations are adequate and loss performance is favorable. Adherence and responses to risk control are also playing a large factor in carrier underwriting.

In the multifamily space, when assets check the box on a long list of underwriting characteristics desired by Midwest & Great Lakes-based carriers, pricing and terms can be extremely competitive relative to the broader market, and particularly relative to large, mixed-state multifamily-only portfolios. Brokers are looking for opportunities to bifurcate portfolios onto separate policies to achieve the most advantageous terms for each asset within a portfolio. While it is an arduous tasks for brokers and risk managers alike, it allows owners to take advantage of the best terms possible for each asset in their portfolio. In the Midwest in particular, newer garden-style apartments with adequate sprinkler protection and a good spread of risk on-site are likely to see better pricing than large, single-structure, frame properties. Portfolios with losses, or that cannot fit into the regional carriers' appetites, are subject to the surplus lines market, where pricing starts at multiples of the admitted market. Loss-heavy portfolios can present large challenges on multiple fronts. The umbrella marketplace continues to be a substantial challenge; especially when there's a need to secure significant limit.

Pressure on adequate valuations remains a major factor impacting renewals. While increasing valuations can be seen as a negative to owners, we believe that it ultimately makes portfolios more marketable and reflects the true risk to a carrier. Insurance carriers do not feel the need to increase rate to offset inadequate valuations, and the opportunities for additional carrier involvement grow when valuations are more in line with construction costs.

MIDWEST & GREAT LAKES RATE CHANGE BY LINE OF COVERAGE

Average Gallagher U.S. Change



- Commercial Auto
- Cyber
- D&O Private Companies
- Environmental Liability
- General Liability
- Property
- Umbrella and/or Excess Liability

Northeast

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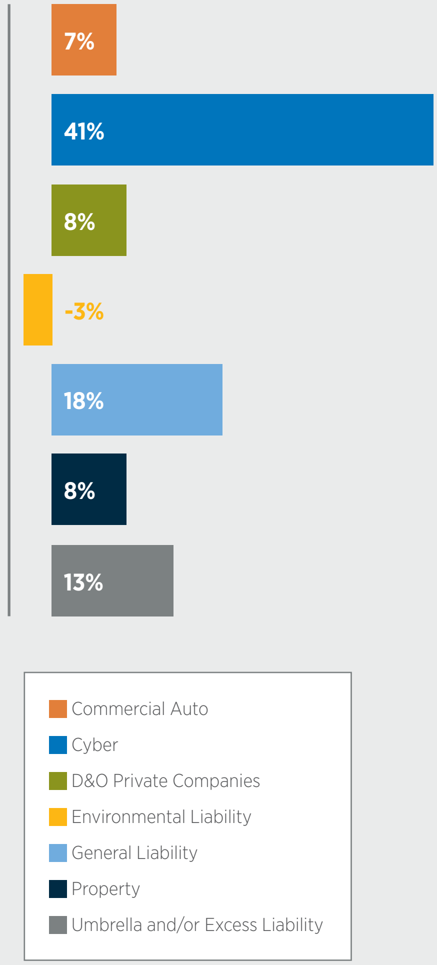
Rates are beginning to stabilize, but a focus on building valuation remains in the forefront. Average rate increases are in the 10% range for clean, non-catastrophe (CAT) exposed accounts. Water damage deductibles of at minimum $100,000 are the new normal. Underwriting due diligence and attention to risk engineering are in clear focus. Carriers are back to pre-inspecting new assets, reviewing rent rolls, and laser-focused on adequate valuations. Underwriters will ask for amendments to property values on submitted statements of values where there are concerns as to the reported building replacement cost valuations and reported rents. Property claims are proving more expensive due to a 15% increase in the cost of building materials in Q2, coupled with labor shortages and supply-chain issues. This further supports the insurance-to-value focus. Underwriting discipline continues.

NORTHEAST RATE CHANGE BY LINE OF COVERAGE

Average Gallagher U.S. Change



Southeast & Mid-South

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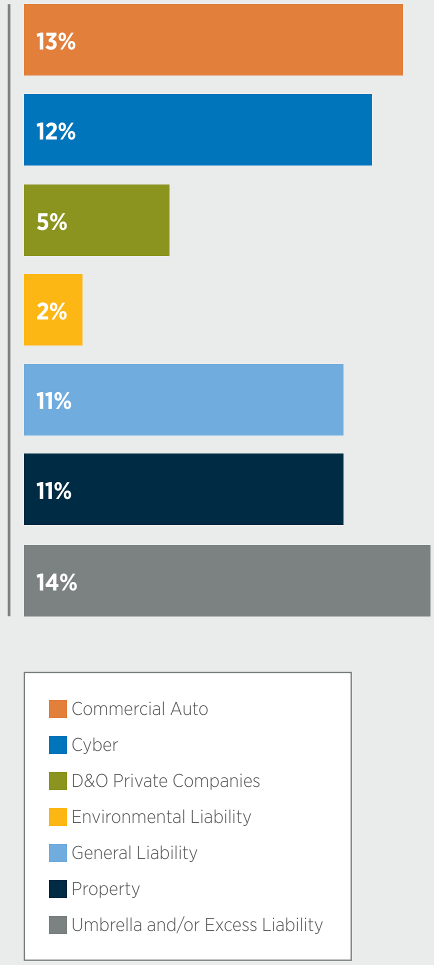
In the Southeast we are starting to see some leveling off in property and liability rates. This goes for all asset classes and even CAT-prone locations provided losses have been minimal. Where this time last year we were seeing 15%–25% rate increases, those increases have dropped to 5%–15% this year, with some renewals coming in closer to flat. Builders Risk rates are still increasing slightly and come with restrictive requirements for security. Water damage deductibles continue to increase and it takes more than one carrier to fill out limits on single-building projects.

Where umbrella rate increases are slowing, capacity is being reduced. Where many carriers once were putting up $25 million in limits, we have seen some carriers cut limits to $10 million to $15 million. Crime scores are also being reviewed by many underwriters and, if they are not good, carriers are passing on new risks or putting up a fight to add a new asset. We have seen some bright spots with accounts in non-CAT areas that saw rate increases over the past two years and are now being rewarded for good results with flat renewals or even slight decreases.

Data is key to good quotes. The more exposure information that can be provided to carriers, the better the look from underwriters. Also, insurance-to-value continues to be reviewed closely, especially given the increase in cost for materials and labor. Carriers are looking at flood very closely and even increasing deductibles or excluding for Zone X locations if they are close to a Zone A.

MID-SOUTH & SOUTHEAST RATE CHANGE BY LINE OF COVERAGE
Average Gallagher U.S. Change



South Central

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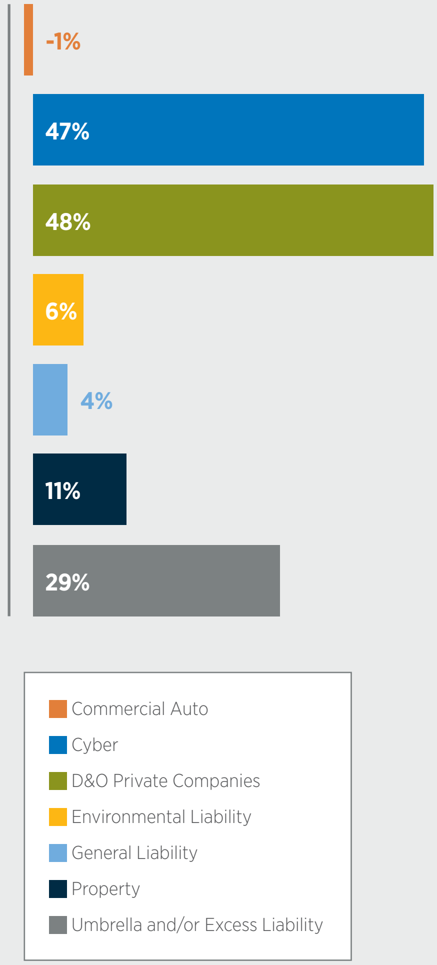
In the third quarter of 2021, we continued to see a push for rate increases across a number of coverage lines (most notably property, umbrella and cyber), although there was some moderation relative to prior years for accounts with clean loss experience and favorable risk profiles. On property, clients experienced an average rate increase of about 15% depending on the asset class and portfolio characteristics. Wood-frame multifamily accounts and clients with claims from Winter Storm Uri are seeing higher increases. Carriers are also adding separate water damage deductibles for mid- and high-rises, which range from $100,000 to $250,000.

Primary casualty is relatively stable with low single-digit rate increases. Umbrella and excess continue to be challenging, particularly for clients who have experienced violent incidents on-site.

SOUTH CENTRAL RATE CHANGE BY LINE OF COVERAGE

Average Gallagher U.S. Change



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