State of the Property Market: 2nd Quarter 2019

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I hope this market update finds you well! Hopefully, the 4th of July holiday provides a nice reprieve from what has been a challenging quarter and certainly a challenging property market. If you are at all like me, I am sure you are feeling a bit exhausted by all the market craziness but excited by the challenges and work that have gone into each deal. Even though we are only six months into the year, I feel like I have taken 10 years off my life. Despite that feeling, I remain truly excited for what lies ahead because I find that every challenge seems to present new opportunities. As summer unfolds, things will slow down for us all and allow us to take a look back on how the market has performed in the hopes that we may see some signs of how the year will progress. If your crystal ball is a bit hazy, then I would suggest you have a few more beers, throw a few more steaks on the grill, and enjoy the summer sun because I can almost guarantee you that when it's over and it is time to get back to work, the market will remain a challenge for the rest of 2019 and likely into 2020—at least that's what my crystal ball tells me!

2019 started with hints of a firm market and then quickly developed into a hard market that has continued to harden each week of each month without any slowdown. In the last three years, carrier profitability hit all-time lows and 2017 and 2018 were marked as some of the worst years carriers have ever seen from an underwriting performance standpoint. Carriers rolled into 2019 with one simple objective: to reposition their books to have a banner year. In order to do this, we have seen rate increase levels start out modest but then swing to severe in many cases on various asset classes. Carriers have pulled away from various asset classes and tightened down terms and conditions on others. They have started to raise their cost of capital charges and loss costs actuarial numbers in order to yield higher rates of return on every account.

For the first time in a long time, we have seen carriers simply walk away from long-term accounts and relationships if they cannot find a way for those accounts to make sense from an underwriting perspective. When 2019 began, it seemed that garden style multi-family business and hospitality business was going to take the brunt of what carriers viewed as much needed market correction. As the second quarter unfolded, however, the needed market correction spread to California with distressed wildfire exposed business, to the Midwest which continues to be impacted by tornadoes and large hail events, and just about every other area around the country. Standard markets have now reined in their appetite and pushed a plethora of business on the excess and surplus lines community, which is happy to write it but is operating much more cautiously than in previous years.

Garden style multi-family business and hospitality business still remain the most challenging assets classes; I think the adversity seen on these two asset classes is the best example of current market conditions. In the multi-family world, you have a short list of carriers that will write larger schedules—and those that will are using very high base rates, minimum deductibles that continue to leave clients with lender issues, and very restrictive terms and conditions that are being driven by systemic replacement cost valuation issues in this space. Rate increases in this class have averaged 10% to 50% depending on the deal and I would say the average account is seeing increases in the 15% to 30% range. In the past, clients could take higher deductibles to bring rates down, but in today's market, we are finding that even higher deductibles are not giving clients the same benefit they used to because of base rates carriers want to implore on risks of this nature.

In today's market, the list of carriers who no longer want to write multi-family business is growing and as it stands, it greatly outnumbers the list of carriers available to write any given risk. The most frustrating part to clients continues to be the lack of differentiation that underwriters are using when driving rate and terms and conditions change. The underwriting approach is very broad brush, and I think carriers are making mistakes here because what could have been a great opportunity to build client loyalty has turned into a very one-sided discussion. In the multi-family world, all the issues are in the primary and that is where the capacity shortfalls remain.

In the hospitality sector, we have the exact opposite problem because the shortfalls are all in the higher excess layers (especially in Gulf coast exposed CAT accounts). We have been through several renewals in the first quarter and second quarter on larger hotel programs where non-renewed capacity represented capacity amounts that exceeded $100M+ and replacing these large slugs of capacity in the higher layers is what drove rate increases another 10%+. The issue with hospitality is that many carriers have lost faith in the modeled results because the losses they have seen from the events of 2017 and 2018 have greatly exceeded both the value of the property and the expected modeled results from those storms. It has become clear that the modeling companies and carriers do not have a good metric for accounting for remediation costs, building ordinance codes, and demand surge that has greatly increased construction and replacement costs in some areas. As a result of the lack of confidence in the modeled output, carriers have become more conservative when it comes to hospitality business and the entire sector has a bit of a black eye.

The outcome of this year's hurricane season will be a huge driver on market conditions at the end of 2019 and into 2020. But even if the wind doesn't blow, you don't get the sense that carriers are inclined to start giving rate back any time soon. This went on for far too long and drove rates to unhealthy levels so I would not expect an immediate change to market conditions. In my opinion, even if the wind doesn't blow, wildfires are kept at bay, and the results are very profitable for most major P&C providers, the harder market is here to stay and something we will need to stay ahead of as we start planning for 2020. If the hurricane season is another active one, and P&C results don't look good, I think clients will need to brace themselves for capacity shortfalls and even tighter terms and conditions.

Below is a breakdown of what we have seen in the market in the second quarter. It is not meant to be doom and gloom, but I have always been of the opinion that honesty is better than blowing smoke:

- **Hab/Multi-family** - Continues to be marked by shortages in capacity with Swiss Re being the most recent carrier to exit the market. Most carriers are now requiring minimum rate levels of $0.20 or more for non-CAT risks, $100K AOP deductibles, and carriers are cracking down on blanket limits and other broker form advantages. Average rate increases are 10% to 50% depending on losses, starting rate, and geography. We have also seen carriers require 2% Wind and Hail Deductibles in key Midwest states and the ability to buy those deductibles down has more or less dried up in the market.
- **Hospitality** - Excess CAT is the biggest challenge and larger programs are coming down to the final weeks to get the programs fully subscribed and supported. Average rate increases are 10% to 35% depending on claims and CAT footprint.
- **General Real Estate/Office** - This continues to be very desirable business and rate change is driven more by geography, but in general, rates are up 7.5% to 15%.
- **Municipal Business/Higher Education** - Several risk pools for municipal business have seen some challenges at renewal as a result of carriers pulling away from shared limits programs and risk purchase groups. As a result, and despite this being a desirable class of business for most carriers, rate increases range 10% to 15% but could be well north of that if the client is coming out of a larger pool or risk purchase group and back into the open market. Additionally, the vast underwriting changes FM Global and AIG have made to this class of business are causing significant pressure on rate and terms in the southern plains.

- **CA EQ/DIC** - This continues to be competitive and capacity is still in abundance but in general, rates are up 5% to 15%. Larger risks who purchase significant CAT limits tend to see higher increases because there is less competition on the larger programs than the smaller middle market accounts, as so many carriers are already subscribed on that business.
- **CA Wildfire Exposed Risks** - This is an area that we have seen evolve at the end of 2018 and then really accelerate in 2019. Changes by standard markets are causing clients to be forced into the excess and surplus lines world and at rates that tend to be 100% to 300% higher than what they were previously paying on a package basis. E&S markets have limited appetite for these risks and are charging high rates with limited capacity to deploy on an account by account basis. This segment is very opportunistic and we have even seen some clients turn to the California Fair Plan for lack of better options.

Many of us have not operated in a market like this in quite some time, and some of us have never operated in a market like this. Those that have seen it before have commented that it can get worse and those that have never experienced it are likely not enjoying the ride but are navigating troubled waters as best they can. Regardless of whether you are a seasoned veteran of this type of market or are hoping to wrap up rookie camp, market conditions will change and market cycles come and go. The best thing you can do now is have open and honest communication with your clients and carrier partners to manage expectations and make sure no one is surprised or caught off guard by the outcome of any deal. There will be some surprises along the way but that is part of the job. One thing this market does better than the others is that it weeds out the good brokers from the bad, the good underwriters from the less savvy, and it allows those with a good handle on their business to rise to the top. RPS continues to be poised to serve our clients with some of the best brokers and underwriters around the country and we hope to continue to earn your trust during this challenging market cycle.


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