Article

Property market update – Rates and Risks

Richard Montminy • June 20, 2023

As we approach the mid-point of 2023, the predictions we made about a hardening property market at the turn of the year have borne out, and the impact of reinsured natural catastrophe losses trickling into the primary market means that there is a further correction coming.

A buoyant 1 April reinsurance renewal, in which the markets continued to see their retentions increase on top of rate increases of as much as 50% on catastrophe loss-affected accounts, rounded off a challenging Q1. This of course continued to drive insurers and reinsurers to carefully evaluate risks across the world to ensure appropriate pricing coupled with tightening terms and conditions.

Overall, US property insurance pricing is seeing an average rate increase of 17%, as the market continues to divide between catastrophe-exposed and non-exposed properties. Catastrophe-exposed properties, coupled with loss experience, are seeing a significantly higher rate increase, trending from 40 to 50%. For clean, non-catastrophe business, the market continues to support moderate rate increases in the single digits.[1]

The start of 2023 does not seem to support future rate relief across the world with Q1 estimated insured natural catastrophe losses to be one of the worst first quarters since 2011. For the US alone, the first half of the year is also not looking to shape up much better with several weather events estimated to each exceed US$1bn. These events included a winter storm, flood and several tornado and hail storms. All of which will continue to tax insurers bottom lines and are setting up 2023 to possibly be another tough year for property insurers before the Hurricane season even gets going. This ongoing rise of weather related events across the globe will continue to keep insurers and reinsurers on their toes – making for some of the hardest property market conditions in 25 years.

The impact of climate change

The first quarter of the year highlighted the very real impact of climate change, evidenced by increasingly frequent and severe weather events. Largely driven by convective storms, the insured loss from global catastrophe events in Q1 is estimated to reach around US$15bn. Meanwhile, the total economic loss is predicted to reach US$63bn, around US$10bn above the 21st century baseline and almost double the US$38bn median.[2]

US risks are particularly acute, with California having experienced a full spectrum of catastrophic events, from wildfire to flooding and winter storms in the last year alone. Meanwhile in Europe, exposure to windstorms is up almost 12% due to inflationary pressures, according to analysis from PERILS.[3]

A trend that has also emerged is the growing prevalence of natural catastrophes in areas which had not previously been exposed to them.[4] For example, we are now seeing flooding and hailstorms in areas where, historically, there has been neither. Rather than named hurricane events, micro-storms are doing tremendous damage to communities which were not previously at the forefront of natural catastrophe risk.

Difficult climate conditions are feeding into capacity challenges. This is especially true for investors, who are beginning to feel they can make more attractive returns elsewhere, given the impact of climate change on loss ratios.

Down the chain, the significant increase in reinsurance costs is being felt by primary insurers. Feeling the sting from recent losses, they are reducing capacity, with some even pulling out of the property market entirely. Those that remain are having to increase prices and tighten terms and conditions.

Inflation is fueling underinsurance risk

The market is also continuing to be impacted by rising inflation, which may begin to cause significant underinsurance of property risks, as valuations may not be keeping pace with rising costs. Insureds have struggled with proper valuations, which has been exacerbated by the increased frequency and severity of large catastrophe claims.

Now more than ever it is important for business owners to insure for their full replacement cost values to avoid coverage shortfalls when significant claims are made for full replacements of lost assets. With the price of construction in the US estimated to be 38% higher than at the beginning of the pandemic[5] , professional valuations are vital.

This challenging market, coupled with the inflationary pressures to continue to support proper replacement cost values, has pushed some large corporations to consider significantly higher deductibles, retention strategies, and/or self-insurance.

However, the small and mid-market business segments typically don’t have robust enough balance sheets to self-insure their assets, making it even more challenging for them to navigate this current market. In our latest Risk & Resilience research, 40% of businesses with a turnover between USD$1m to US$9.99m told us that they do not feel prepared to face property damage risks resulting from climate change. Preparedness grows significantly as businesses enter the USD$10m-US$100mn revenue bracket, as only 21% report they feel unprepared.

By sector, 25% of executives in commercial property, real estate and construction, regardless of business size, said they do not feel prepared to respond to the risks of climate change.

A more specialist approach is required

Over the years, property had become a more commoditised market. However, the attention today on the management of climate-related issues and exposures means property is becoming an increasingly specialist risk class.

A combination of rising inflation, constrained capacity and increasingly unpredictable incidence of natural catastrophes means we can no longer rely on the past to be an accurate barometer of future risk.

To underwrite property risks effectively and support insureds today we must understand how climate change is impacting those risks, and explore solutions that help mitigate and adapt to them.

As Beth Diamond, our Group Head of Claims recently discussed as part of her analysis of the impact that climate change is having on property risk, part of the solution will mean embedding support for communities we now know are at greater risk, such as those experiencing unprecedented micro-storms, and acting quickly to re-allocate resource.

We must also expect and embrace evolution in regulation. Europe has made great strides already and we're expecting the US to follow suit in the introduction of its natural catastrophe schemes. Work to date to ensure the right building codes are used will be an important factor in bolstering resilience and managing damage resulting from a severe weather event.

Intensifying property exposures linked to the growing severity of natural catastrophe risks undoubtedly present a challenge for insureds. As the line between catastrophe and non-catastrophe-exposed areas becomes increasingly blurred, and the skills required to underwrite the risk swing back to specialist insurers, we are proud to commit to the property market for the long-term

Richard Montminy's market view

2https://www.insuranceinsider.com/article/2bj6ymnlmyex408s4737k/brokers-section/aon-pegs-q1-global-cat-losses-at-15bn-and-warns-of-further-loss-development

3 https://www.perils.org/files/News/2023/Exposure-Database/20230425-PERILS-Press-Release-Industry-Exposure-Database-2023.pdf

4When Disaster Strikes, Is Climate Change to Blame? - Scientific American

5https://www.abc.org/News-Media/News-Releases/entryid/19802/abc-construction-materials-prices-rise-1-in-january-up-5-from-a-year-ago advice. It should not be construed or relied upon as legal advice and is not intended as a substitute for consultation with counsel. Beazley has not examined and/ or had access to any particular circumstances, needs, contracts and/or operations of any party having access to this document. There may be specific issues under applicable law, or related to the particular circumstances of your contracts or operations, for which you may wish the assistance of counsel. Although reasonable care has been taken in preparing the information set forth in this document, Beazley accepts no responsibility for any errors it may contain or for any losses allegedly attributable to this information.

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