WHITE PAPER

Changing Dynamics in Property Insurance

AUTHORED BY:

Mary T. Pipino, CPCU
Executive Vice President

Theodore S. Pipino
Senior Vice President

Introduction

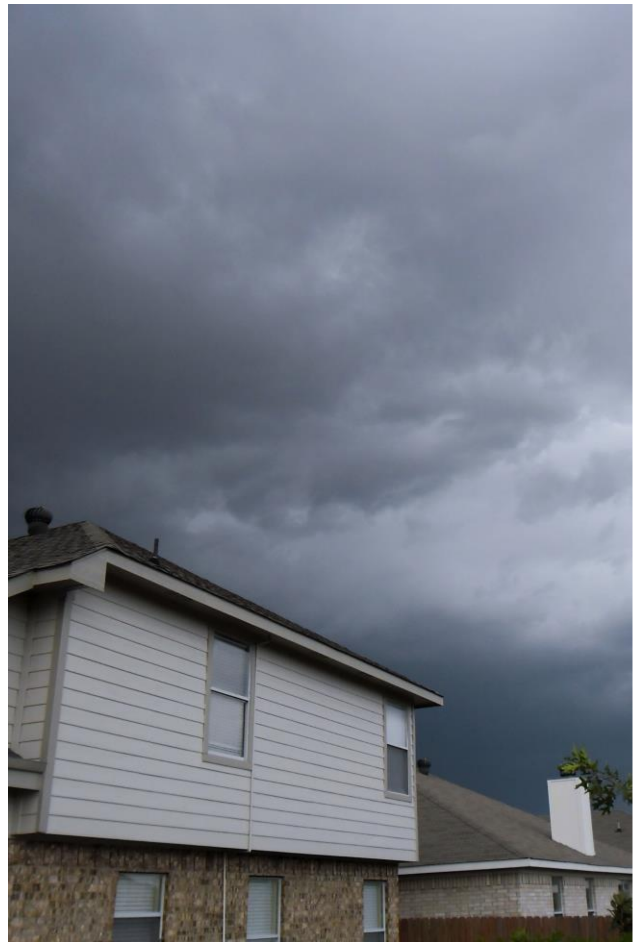
Just like in 2020, weather-related claims proved to be expensive in 2021. According to a December 21, 2021, article published in the Claims Journal, a reported $105 billion in weather-related claims was reported – the fourth highest on record. This number does not include the $531 billion in losses that occurred on December 30 due to 105 mph wind gusts that fueled a Colorado wildfire, which could drive the total cost even higher.

As the adage says, no one can control the weather. While that is true, a knowledgeable risk management and insurance professional can help provide risk mitigation and management insights to help protect your property and financial assets and provide you peace of mind.

A significant portion of these losses occurred in the coastal regions of the United States. Eight named storms hit the country during the 2021 season, nearly triple the average of three landfalls per hurricane season. Combined with 2020's record-setting 11 landfalls, there have been 19 storms to hit the United States over the past two years.

The National Oceanic and Atmospheric Administration's (NOAA) Office for Coastal Management reported that approximately 128 million people, about 40% of the country's total population, live within America's coastal regions. The population density is 461 people per square mile versus 87 for all other areas of the country (excluding Alaska). Since these regions produce more than $9.5 trillion in goods and services each year, it is no surprise that commercial real estate in these regions continues to grow as a large number of people relocate to the coast every year.

From a property coverage perspective, insuring coastal properties can be challenging in terms of cost and availability of coverage. However, wind and water exposures are not just a problem for coastal properties. In fact, weather-related losses from "named storms" have expanded in frequency, intensity and geographic reach. For the insured, this means these named storms that were once primarily impactful for coastal properties owners are now a more significant concern for areas farther and farther inland. The impact of these storms over the last several years necessitates rethinking of catastrophic loss modeling, as historical loss models are no longer entirely sufficient.



Let's examine 2021's most expensive natural disaster, Hurricane Ida. In total, damage was reported in almost a dozen states, with resulting losses between $50 and $60 billion. A significant portion of Ida-related losses came from six states – from Mississippi to Massachusetts – where hurricane-spawned tornadoes touched down, the most powerful of which was an EF3 (wind speeds between 136-156 mph on the Enhanced Fujita scale). Massive urban flooding in the high population density areas of New York and New Jersey also resulted in catastrophic losses. At one point, New York City's Central Park received 3.15 inches of rain per hour.

When Hurricane Ida made landfall in Louisiana with sustained winds of 150 mph, it was the fifth strongest hurricane to strike the United States, according to Phil Klotzbach, lead author of Colorado State University's Tropical Meteorology Project that studies hurricanes. In addition to wind damage, a storm surge of 10-plus feet was commonplace and rendered parts of the initial impact zone uninhabitable for months. Loss of life included six deaths in the initial impact zone. By comparison, there were 23 deaths in New Jersey, 17 in New York, three in Pennsylvania and one each in Connecticut and Maryland from flood-related causes.

Consider this – between Hurricane Wilma in late 2005 and Hurricane Harvey in 2017, there were no hurricanes rated higher than Category 2 that made landfall in the United States. While in just the last four years (2017-2021), there have been seven Category 3-plus hurricanes that made landfall with winds over 111 mph. This storm count includes Hurricane Harvey and Hurricane Michael, a Category 5 storm with winds of 160 mph that hit the Florida Panhandle in 2018. Four of the seven storms made landfall from the Gulf Coast. As evidenced by the facts above, the trend for these super-storm events is rising.

To help protect your properties from coastal exposures, it is important to consider both wind coverage, including named wind and hail, as well as flood coverage. Since these perils are often excluded or offered with limited coverage in standard policies, properties in coastal areas may need a specific policy provided by an excess or surplus (E&S) market. E&S is a specialty market that insures complex or high-risk exposures that standard carriers will not entertain. Insurers in the E&S market are considered "non-admitted" or "non-filed" because they do not need to file rates for approval with state insurance departments, giving the insurer greater flexibility in setting rates and drafting policy language necessary to handle these complex or high-risk exposures. However, it is important to note that E&S carriers are not backed by a state's fund for insolvency.

Managing Your Premiums

Unlike standard property policies, flat dollar amount deductibles do not apply to wind exposure policies. Instead, there are percentage deductibles. These deductibles range between 2%-10% of your property's insured value. Typically, these deductibles are applied to your real property and business interruption separately.

Speaking of business interruption, how will this affect your recovery if you have abatement provisions in your leases?

The result is that you, as the property owner, could be saddled with a large out-of-pocket payment before your insurance coverage kicks in. However, you may be able to lessen the impact of these out-of-pocket expenses by purchasing wind buy-back insurance, a type of policy that allows you to buy down by percentage increments from the stated percentage deductible.

In addition to lessening the severity of your deductible payment, these policies could also help in meeting lender mortgage requirements. Most mortgage lenders for real estate properties have specific and stringent coastal wind and flood coverage requirements. These requirements could also include specific financial strength criteria for carriers as well as other considerations. Make sure you review and understand those specific requirements and convey them to your insurance provider to avoid undesired consequences in the event of a loss.

Another possible solution is parametric insurance. As a result of events like Hurricane Ida, many insurers are rebalancing their portfolios by reducing their capacity in loss-stricken areas, shoring up their underwriting guidelines and increasing premiums and/or deductibles. Unfortunately, those properties with the highest exposure to loss are the most adversely impacted by this hardening market. Parametric insurance offers an alternative to traditional insurance products to assist in funding losses.

Simply put, parametric insurance is based on the probability of a predefined event happening and, after it happens, paying out according to a predefined matrix up to a defined limit. By comparison, a traditional policy indemnifies for an insured peril that meets required policy conditions.

Parametric Coverage

Generally speaking, the primary use for parametric insurance is as a complement to traditional insurance coverage. Compared to a conventional policy, the advantages are:

- Fewer restrictions and exclusions;
- Guaranteed payout when the conditions are met;
- A payout is made with or without the policy holder sustaining damage or loss;
- Quick payout after a triggering event (typically less than 30 days).

It is important to remember that the risk basis for parametric insurance requires an in-depth understanding of the insured's exposure to the peril in question, loss probability and other data points related to the threat being covered.

Here's how it could work in the case of "named storm" perils.

- The insured will pick a geographic point, for example, Miami, Florida.
- Agreed upon parameters for the "triggering event" are then established.
    - » For this example, let's use Category 3 or greater "named storms" within a 15-mile radius of Miami, Florida.
- If the "triggering event" occurs, the payout is made up to the limits established.

In addition to wind buybacks and parametric solutions, other options for funding for "named storm" percentage deductibles may be available, depending on your specific situation. In any case, given the intricacies associated with high-risk exposures, it is valuable to seek an experienced insurance professional that specializes in high-risk property coverage placement before proceeding.

Coverage Triggers Considerations

How does your policy address events designated as a "named storm" by a meteorological agency such as NOAA? What about named storms that become down-graded to tropical depressions? Tornados spawned by a "named storm?" Will your percentage deductible for "named storm" also apply to losses from these events?

Are there any time element provisions to determine what constitutes an occurrence? For example, your policy may state that events occurring within 72 hours of landfall may be considered one event. It is imperative to have a thorough understanding of the implications of this timeframe and how it could impact your out-of-pocket expenses for your deductible or the exhaustion of your policy limits.

Flood is Flood? Wind is Wind?

There is plenty of confusion about what is covered under which policy – wind or flood. In fact, it is the subject of scholarly debate in academic research regarding hurricanes. Wind-driven rain, the sudden and temporary entry of rain, snow, sleet, or ice pushed into a building by wind, is a different peril than flood and is often excluded under a flood policy. The issue of how your coverage responds usually arises after a storm when the two are likely to combine. Understanding your coverages, exclusions and the definitions of the covered perils compared to price is important to your coverage selection process.

The most often thought of underwriter for flood insurance is FEMA through the National Flood Insurance Program (NFIP). This program's maximum coverage limits for commercial properties are $500,000 per building and $500,000 for contents per building. There is no business interruption component. Valuation is on an Actual Cash Value (ACV) and not replacement cost. What constitutes insured property and loss adjustments is defined per the Federal program guidelines. The limitations of the NFIP could potentially create a significant financial shortfall in restoring your property to pre-event conditions in the event of a loss. For that reason, an excess policy may be needed to augment NFIP coverage. Keep in mind that private insurers are now offering alternatives to FEMA with broader coverage options.

Insuring your coastal exposures can be challenging. We offer comprehensive risk management services that can help coordinate and capture the value of your insurance and risk management efforts into measurable results that help you meet your goals and objectives.

The next time the subject of insurance comes up, discuss the value of an experienced risk management professional's guidance in helping you to manage your total cost of risk.

About the Authors

Mary T. Pipino, CPCU, *Executive Vice President*

Mary has more than 35 years of experience creating innovative, analytic solutions focused on customers' bottom lines and helping to improve the total cost of risk. Prior to joining Brown & Brown, she was the sole owner, President and CEO of Donald P. Pipino Company, LTD, a prominent insurance risk management firm in the real estate industry. Mary's customer-focused innovations include a proprietary full-service Claims Management Program with TPA, a Certificate Monitoring Program and Financial Risk Management Services.

Theodore S. Pipino, *Senior Vice President*

Ted has more than 35 years of experience in all facets of designing and administering comprehensive insurance and risk management programs for large commercial accounts. Throughout his tenure, Ted designed, marketed and placed layered coverage programs for sophisticated risk, which have exceeded over $100 million for a single project. A graduate of Kent State University and Aetna Sales and Training, Ted maintains both his Ohio insurance license and a non-resident agent's license in the State of California.

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