Urban Land Institute

HEITMAN

A REAL ESTATE INVESTMENT MANAGEMENT FIRM

INSURANCE ON THE RISE

CLIMATE RISK AND REAL ESTATE INVESTMENT DECISIONS

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Executive Summary

A NOTE ON INSURANCE

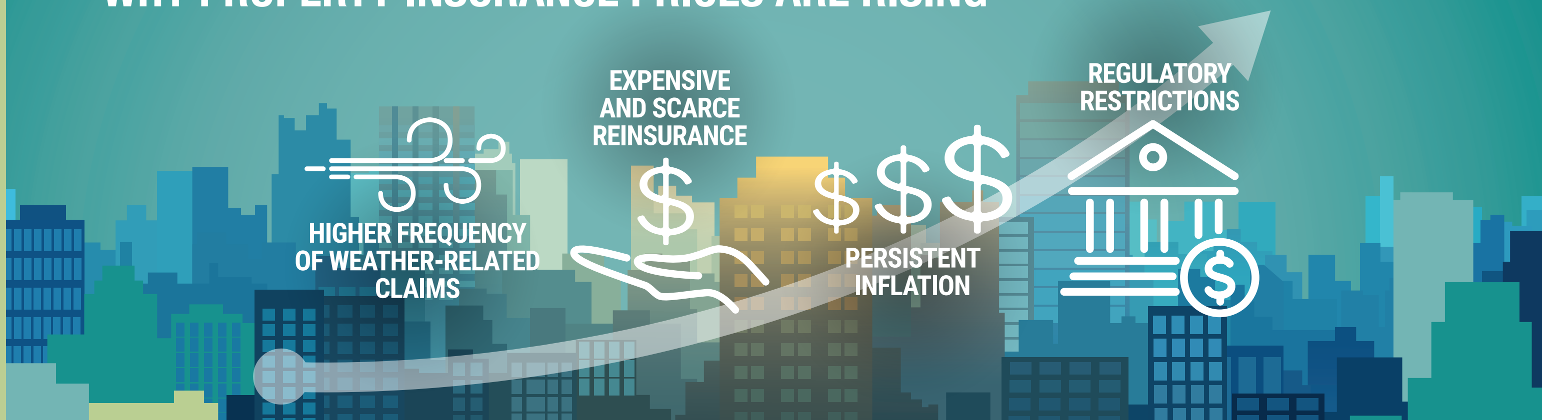
This report focuses on commercial real estate (CRE) *property* insurance. Property insurance is used by asset owners to mitigate the risk of loss related to physical damages or changes from common hazards, including fire, theft, wind, and flooding. Most insurance coverage is obtained as a bundle containing a variety of protections, such as property, casualty (liability), business interruption, and additional special coverages (e.g., terrorism). As much as possible, this report parses out the implications to commercial real estate owners and investors of changes to the property portion of the policies.

A glossary of insurance terms can be found on page 40.

The insurance industry serves an essential function in facilitating CRE ownership around the world. This report outlines the critical intersection of insurance, physical climate risk, and property coverage in the global commercial real estate sector, examining the challenges arising from rapid growth in the number and intensity of natural catastrophes.

Recent years have seen insurance costs rise due to factors including inflation, the increasing frequency and scale of natural disasters, reinsurance market liquidity issues, and regulatory constraints. As insurers raise premiums, modify terms and conditions, enact stricter underwriting protocols, impose higher deductibles, and reduce coverage, the real estate industry is challenged to secure adequate coverage that satisfies lender requirements. Further, property owners are finding their net operating incomes reduced as insurance costs increase and—in some cases—are seeing transactions falter or valuations decline.

In response, investors have been forced to retain additional financial risk while working to assemble a cadre of multiple insurers to provide the coverage levels needed. They are devising new approaches to managing risk by stitching together coverage from multiple insurance carriers and employing alternative risk-financing solutions such as captives



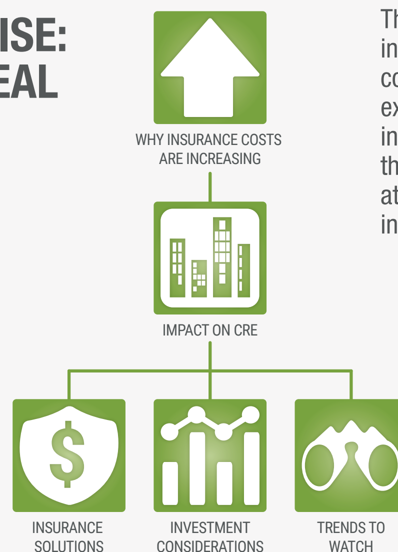
and self-insurance. This shift toward more complex insurance solutions, often facilitated by third-party consultants, reflects a strategic response to rising insurance costs.

Higher insurance costs are also influencing investor behavior. While markets with higher climate risk are not off the table for investors, investors are carefully considering individual asset exposure, the likelihood of losses over the hold period, and the risk appetite of future buyers, as well as evaluating asset vulnerability and investing in risk-reduction strategies. Investors are also watching insurance trends within the single-family residential market, anticipating that higher costs and diminished availability of homeowners insurance could have implications for commercial real estate demand if they prompt changes in migration patterns. While the insurance market may shift into a period of increased competition should additional capital enter the marketplace, the business practices insurers and reinsurers have embraced are unlikely to disappear. Rates may decrease, but higher deductibles, lower coverage limits, and efforts to collect adequate premiums are projected to remain.[1] Savvy investors will need to not only identify creative coverage opportunities but also manage physical climate risk strategically to build portfolios that can attract affordable insurance policies and maintain profitability.

To aid investors, this report details the following:

- How the higher frequency of weather-related claims, expensive and scarce reinsurance, persistent inflation, and regulatory restrictions are driving up property insurance prices (see page 3) and the effect of increasing costs on CRE owners (see page 10);
- Strategies for securing affordable insurance coverage, such as opting for higher deductibles or aggregate deductibles, employing self-insurance, self-insured retentions, or captives, and leveraging parametric and/or excess and surplus line coverage (see page 17);
- Investment considerations, such as portfolio size and geographic diversity, asset and market exposure to physical climate risk, asset and construction type, or the presence of asset hardening strategies, that may make a building or portfolio more attractive to insurers (see page 25); and
- Emerging trends and insurance impacts that could reshape markets, including the higher frequency and severity of secondary perils, the possibility of insurance-driven migration, the growing insurance protection gap, and the viability of government-backed insurance programs (see page 31).

INSURANCE ON THE RISE: CLIMATE RISK AND REAL ESTATE INVESTMENT DECISIONS



This report explores why insurance costs are increasing and the effect of rising insurance costs on commercial real estate owners. It also examines strategies for securing affordable insurance coverage, investment considerations that may make a building or portfolio more attractive to insurers, and emerging trends and insurance impacts that could reshape markets.

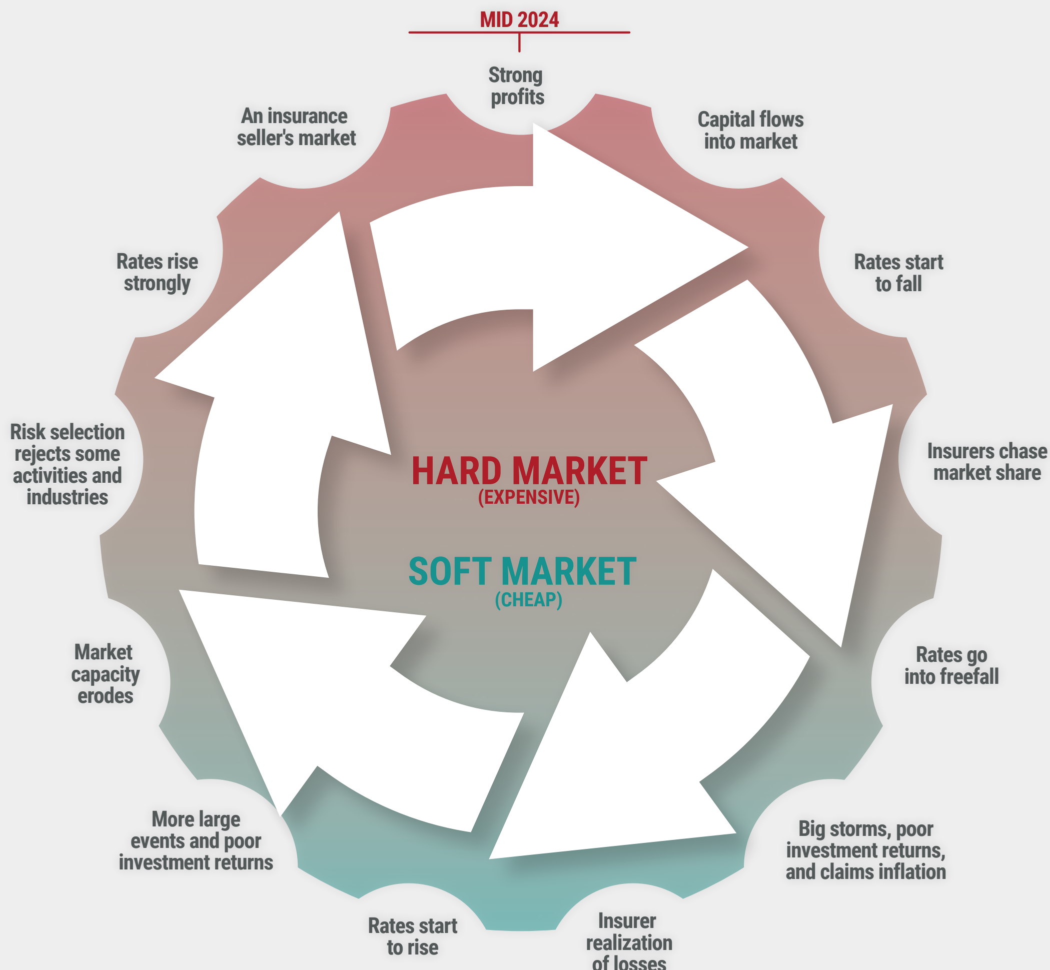
Behind the Rise of Property Insurance Costs

Traditionally, the property and casualty insurance industry is inherently cyclical, marked by periods of “soft” and “hard” market conditions (see Insurance Cycle infographic).

In a soft market, premium rates tend to be stable or to decrease due to high competition among insurers, making insurance products more accessible. This competition can erode insurance carriers’ capital reserves as premium income drops, and any increase in claims diminishes profits. Consequently, the reduced capital needed for underwriting new business can initiate a transition to a hard market cycle. Events like major catastrophes can accelerate this shift by imposing sudden, severe losses on the industry.

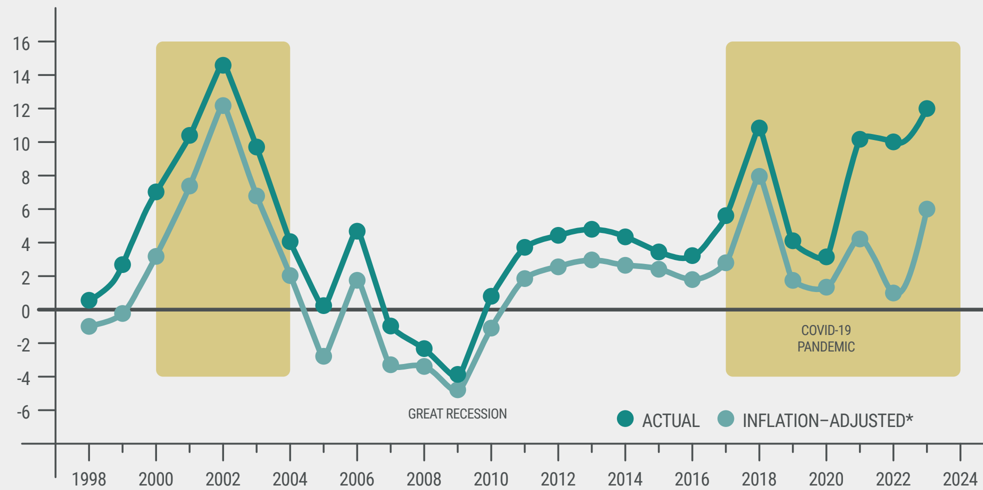
INSURANCE CYCLE

This diagram shows the typical insurance cycle. (Building Bridges Between Businesses)



HARD MARKETS

This diagram of the percent change in year-to-year net property and casualty insurance premiums from 1988–2023 highlights years of hard market conditions. (NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute)



* Adjusted for inflation by the Insurance Information Institute using the GDP implicit price deflator.

A hard market is characterized by rising premium rates and less available coverage as insurers try to recover profitability. The reduced competition sees insurers imposing stricter underwriting standards. Over time, as profits increase, capital is attracted to the industry, leading to a renewed phase of softer market conditions due to heightened competition.

The 2017–2024* hard market deviates from historical patterns, being described as the longest experienced, according to an insurance broker with over three decades in the industry (see Hard Markets graph). This prolonged hard market stems from a unique convergence of multiple threats, including expensive and scarce reinsurance, persistent inflation, regulatory restrictions, and higher claims-related costs due to more frequent and severe weather-related events.

Insurance Losses Due to Physical Climate Risk

Insurance companies are in the business of risk. They are one of the first industries to be affected by climate change, and thus serve as an early indicator of broader financial disruptions. More frequent and more severe natural disasters and the increasing development of high-value properties in areas prone to such hazards have consequently put increased pressure on the insurance industry (see Number of Billion-Dollar Insured Losses from Extreme Weather Events in 2023 graph).

The United States has a notable impact on the global insurance and reinsurance markets due to its extensive use of insurance for risk management, with U.S. losses accounting for 75 percent of global insured losses in 2022.

The year 2023 stands out as the warmest on record and witnessed a record 28 separate

* As of this writing, hard market conditions are expected to ease in 2025, according to Swiss Re.

billion-dollar weather and climate disasters in the United States, ranging from severe storms and floods to wildfires and droughts, totaling US$92.9 billion in damage nationwide.

Both Europe and the United States suffered from violent thunderstorms (also known as severe convective storms), with hail causing significant property damage. In addition, Typhoon Doksuri caused damage to the Philippines and China. The year 2023 was also Canada's most severe wildfire season, and Hurricane Otis became Mexico's costliest insured event to date.

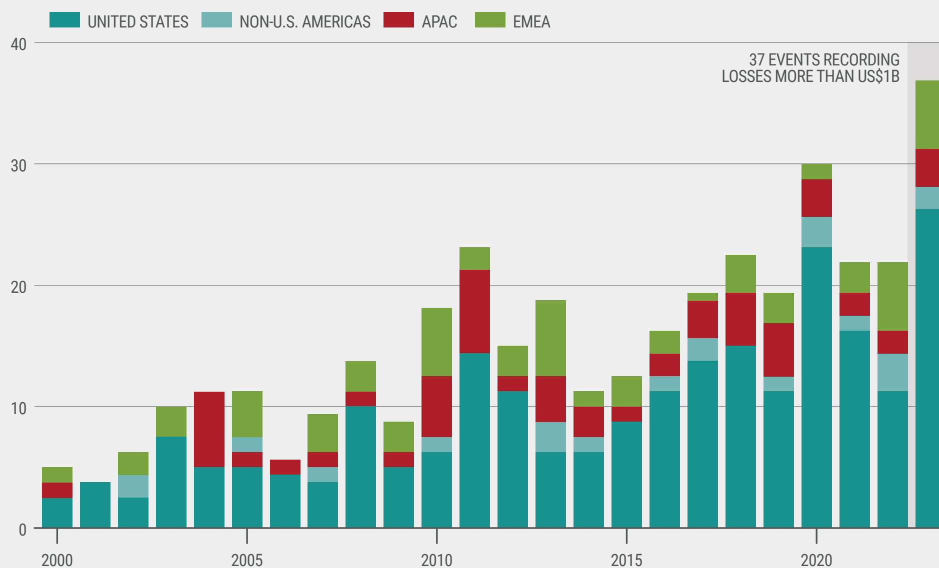
The growing frequency and intensity of catastrophic events has translated into rising losses for reinsurers, the entities that insure insurance carriers. Global insured losses due to natural catastrophes hit US$123 billion in 2023, continuing a trend with losses topping US$100 billion for the fourth straight year. Focusing solely on climate and weather-related events, losses were estimated at US$116 billion.[2]

Swiss Re anticipates that insured losses could double in the next decade due to the increasing frequency and intensity of extreme weather events, driven by rising temperatures (see Global Growth of Insured Losses from Natural Catastrophes graph). This projection comes amidst an observation that insured losses have been growing at an average rate of 5.9 percent over the past 30 years, outpacing the global GDP growth rate of 2.7 percent.

SWISS RE ANTICIPATES THAT INSURED LOSSES COULD DOUBLE IN THE NEXT DECADE DUE TO THE INCREASING FREQUENCY AND INTENSITY OF EXTREME WEATHER EVENTS, DRIVEN BY RISING TEMPERATURES.

NUMBER OF BILLION-DOLLAR INSURED LOSSES FROM EXTREME WEATHER EVENTS IN 2023

More frequent and more severe natural disasters and the increasing development of high-value properties in areas prone to such hazards have increased insurance industry losses. ("The Uninsurable World: How the Insurance Industry Fell Behind on Climate Change," *Financial Times*, June 2, 2024)



This has led to a crisis within the insurance industry, with the commercial real estate sector experiencing skyrocketing insurance rates (in the United States).[3]

Reinsurance Cost and Availability of Capacity

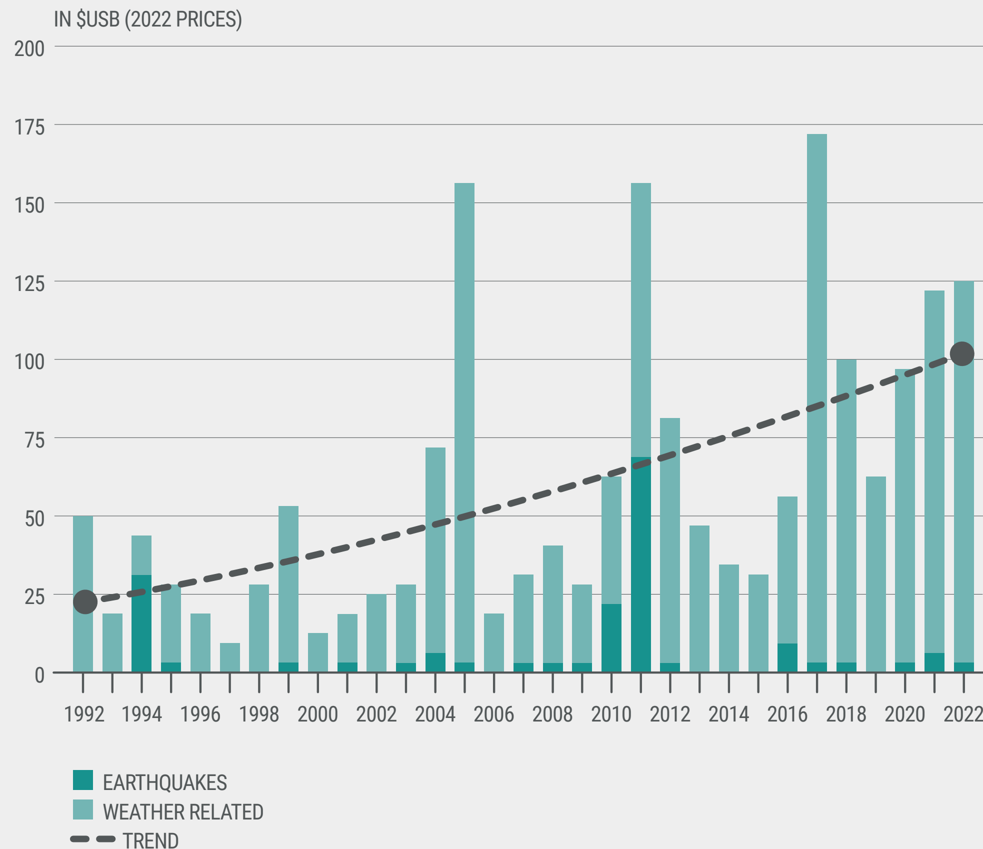
In recent years, the reinsurance industry, which offers insurance to insurance companies, has seen a significant increase in costs as a response to the growing risks associated with climate change–induced storms, as well as factors such as the Russia-Ukraine conflict, further escalation of the war in the Middle East, and low equity returns.

The reinsurance industry has faced substantial challenges, with an estimated US$46 billion in capital (approximately 16 percent) exiting the market between 2021 and 2022, further exacerbated by reduced capacity as some reinsurers withdrew from the property catastrophe (CAT) segment.

This retreat has been driven by accumulating losses from primary insurers and affected by increasing interest rates, which have devalued bond portfolios and caused reinsurers' return on equity to plummet (see

GLOBAL GROWTH OF INSURED LOSSES FROM NATURAL CATASTROPHES

Since 1992, insured losses from natural catastrophes have grown by 5–7 percent on an average annual basis. (Swiss Re Institute, "Natural Catastrophes and Inflation in 2022: A Perfect Storm," No 1/2023 SIGMA)



Reinsurers' Profitability Since 2010 graph). This scenario led to a stark increase in reinsurance prices. As an example, U.S. property catastrophe reinsurance rates have more than doubled since 2017. Specific regions such as coastal Texas have also felt the pinch, with one insurer experiencing a 63 percent hike in reinsurance costs in 2023. European reinsurance rates were up 30 percent on average from the prior year at the start of 2023.[4]

The Burden of Inflation

The aftermath of COVID-19 brought supply chain disruptions and labor shortages that contributed to soaring inflation. Other factors have put additional pressure on U.S. property insurers, including legal system abuses, claims fraud, and claims inflation.

Insurers increasingly use the term "social inflation" to describe why their claims costs are increasing at a rate that exceeds the general rate of inflation, which they call "economic inflation." Rising social inflation reflects a trend of increasing litigation costs brought by plaintiffs seeking large monetary relief for their injuries or additional monies for disputed property damages. These claims often take a long time to resolve, necessitating additional insurer expenses.

In Louisiana, for example, what has been characterized as legal system abuse has been estimated to cost each resident of the state more than US$1,100 per year. In Florida, insurers have been placed in scenarios where they reluctantly agreed to large settlements to avoid court-ordered fees and, in turn, raised premiums to cover legal costs and other risks.[5]

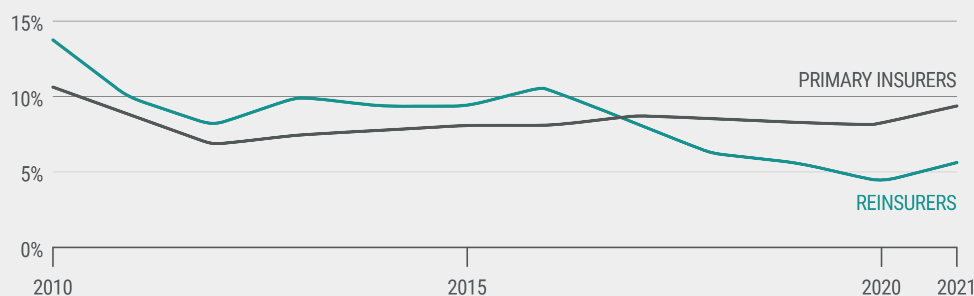
Social inflation is not just a U.S. concern. While the number of class action lawsuits grew by 2 percent annually between 2015 and 2019 in the United States, outside the United States, the annual growth rate was 15 percent. More than 65 percent of the securities class actions in the European Union and the United Kingdom are backed by "litigation funders" (third-party investors).[6]

Theft is also leading to increased claims; with copper prices high, outdoor air-conditioning units frequently are targeted for their copper. Buildings that are left unoccupied at night, as well as those located in rural areas, are considered easy targets. Sophisticated criminal organizations are targeting warehouses, distribution facilities, and cargo carriers, while retail theft continues to be problematic in large urban areas.[7,8]

REINSURERS' PROFITABILITY SINCE 2010

FIVE-YEAR AVERAGE RETURN ON EQUITY

Increasing interest rates have devalued bond portfolios and caused low return on reinsurers' equity. ("Reinsurers Defend against Rising Tide of Natural Catastrophe Losses, for Now," Moody's, January 10, 2023)



The insurance sector is further burdened by inflationary pressures on claim loss costs, driven by rising material and labor expenses (see Construction Cost Increases versus CPI graph). Along with the frequency and severity of disasters affecting supply availability, this situation creates a perfect storm where both reinsurance and operational costs escalate, justifying the hike in premiums.

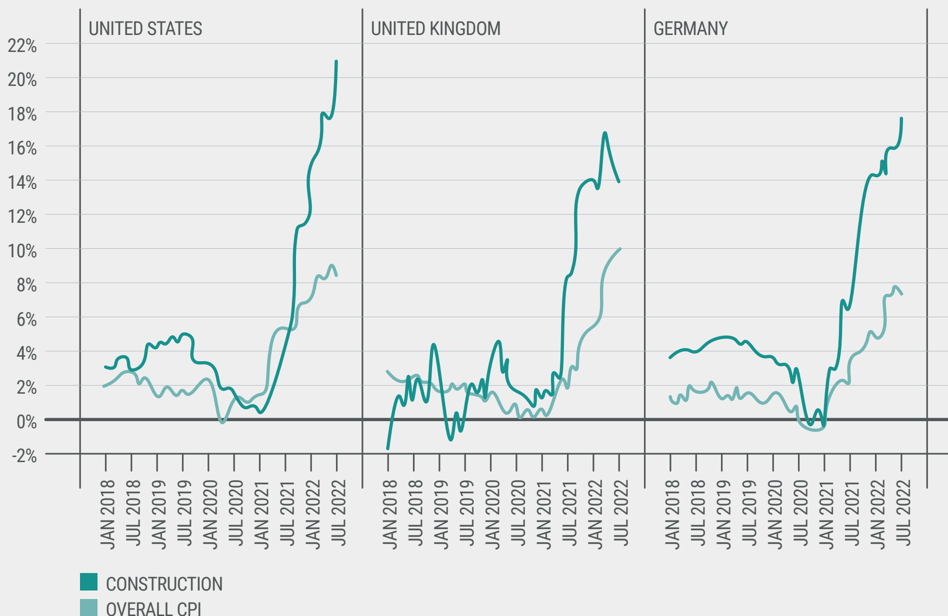
Regulatory Impacts on Insurance

Certain governmental regulations have contributed to the pressures faced by insurers, leading some to withdraw from certain markets altogether. At present, this issue has had significant impact for single-family homeowners in certain geographic locations. For example, California's consumer protection measures capped insurance rate increases and excluded reinsurance costs from rate calculations, resulting in an actuarily unsound insurance environment. Between 2013 and 2022, California homeowners insurers paid out an average of US$108 for every US$100 they took in, eroding any reserves the insurance carriers had set aside for future disasters.[9] These increased losses, coupled with California's restrictions on rate increases, created conditions where some well-known carriers elected to exit the California market. In 2023, State Farm, Allstate, and Farmers—companies that cover over 40 percent of the state's home insurance market—were joined by American National in 2024 in leaving the state of California, citing rising costs and decreasing profits.[10]

Other areas that are tightly regulating insurance rate increases may find themselves in similar positions. In 2019, the Texas Windstorm Insurance Association (TWIA), created in 1971 to provide wind coverage

CONSTRUCTION COST INCREASES VERSUS CPI

Construction costs are rising rapidly, contributing to higher insurance premiums by increasing replacement costs. (Howden, "Reinsurance: A Tipping Point")



for property owners in coastal Texas, proposed a 10 percent rate increase. This request was blocked by the governor. However, a 2024 actuarial analysis suggested TWIA rates would need to increase by 38 percent and 45 percent for residential and commercial policies, respectively, to be considered adequate.[11] Over a five-year span from 2019 to 2023, TWIA raised rates once by 5 percent for both residential and commercial properties.

Meanwhile, in June of 2024, the North Carolina Insurance Commissioner limited dwelling insurance rate increases to an average of 8 percent statewide, in contrast to a requested 50.6 percent hike by the North Carolina Rate Bureau.

When the risks are too great or regulations too restrictive, the insurer may have to make the business decision to exit a market. As one insurer stated, "We want to be there, but when the math doesn't work for a company, they have to make those decisions." While this trend has primarily affected single-family homeowners, investors see this behavior as a potential harbinger for commercial real estate.

Uneven Impacts across the Globe

Between 2016 and 2021, global "insured natural catastrophe losses averaged about US$100 billion, with 71 percent of the losses occurring in North America, followed by 12 percent in Asia and 11 percent in Europe."[12]

Accordingly, interviewees worldwide reported that insurance pricing issues are most pronounced in the United States. Since 2017, U.S. CRE property insurance rates grew by 7.6 percent annually. Those rate increases accelerated in 2023, with a year-over-year increase of more than 17 percent in some U.S. markets.[13]

In contrast, European commercial insurance rates rose on average 4 percent in the last quarter of 2023, down from the 6 percent rise seen at the end of 2022.[14] Data reflects slight rate adjustments in Asian property insurance for 2023, with a minor dip observed in early 2024, excluding CAT-exposed zones where increased deductibles or higher retentions are common.

An Australian real estate management company noted a moderate premium rise due to increased total insured value (TIV), viewed as typical and manageable. However, the long-term outlook in the Asia Pacific (APAC) region remains uncertain with the dual pressure of rising demand and climate change impacts. The region's share of global insurance premiums has grown, and a significant rate increase is forecasted through 2027. A study highlighted the vulnerability of nearly 10 percent of properties in leading APAC real estate investment trusts (REITs) to climate change,[15] indicating a potential shift toward higher insurance costs as seen in the United States due to similar pressures of insuring high-value assets in risk-prone areas.

Despite relatively stable costs outside the United States, concerns about climate change–induced premium hikes are being acknowledged across the globe.

Impacts on the Real Estate Industry

> "Without insurance, deals don't close and investors/owners don't withstand losses. Although not insignificant, insurance costs historically were manageable, despite being subject to pricing fluctuations from the cyclical insurance market. Recently, the impact of insurance costs has become more material across all industries, especially CRE—and no more so than for those assets perceived to be in harm's way of [natural catastrophes]."[16]
>
> **U.S.-BASED INVESTMENT MANAGER**

Insurance cost impacts on the real estate industry are not new. A 2011 survey by the U.S. National Multifamily Housing Council indicated that nearly one-third of respondents identified increasing property insurance premiums as the primary factor behind surging operational expenses. At the time, property insurance costs in Kansas City, Missouri, for instance, jumped 20 percent.

The 2017–2024 hard insurance market has further affected the US$20 trillion CRE sector, with property owners experiencing substantial premium hikes that have challenged the financial viability of some investments. In 2022, a U.S. REIT with over 20 million square feet of property on the West Coast saw its insurance premiums skyrocket from US$6.5 million to US$21.7 million.

Insurance price escalation is just one factor. Globe Street reported that "Certain [insurance] carriers have been restricted to either not providing quotes if a portfolio's dollars-per-square-foot estimate is too low or manually inflating clients' portfolio values and assigning pricing of an increased portfolio value set."[17] The 2023 NMHC *State of Multifamily Risk Survey and Report* noted that "If a firm's values are not up to a standard accepted in the marketplace, insurance carriers may restrict capacity and impose coverage limitations on policies that will impact recovery in the event of a severe casualty."

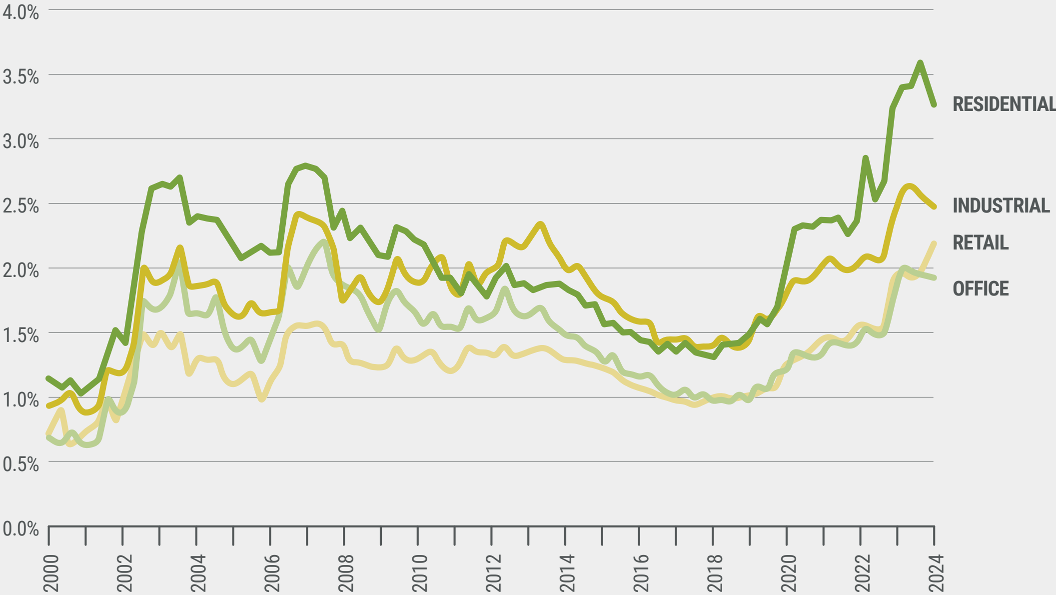
Insurance Impacts on CRE Revenues and Expenses

Per the National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index, U.S. commercial real estate prices as of Q2 2024 had depreciated by 18.5 percent since the Federal Reserve began raising interest rates in early 2022.[18] Rising mortgage interest rates and high vacancy rates contributed to the decline, and while insurance costs are a small percentage of expenses, running at 4 percent in 2018 to 7 percent in 2024 of expenses for the multifamily residential sector per NCREIF, insurance increases drove nearly 2 percent of revenue margin erosion for apartments over the past four years. Insurance volatility and sharp increases are contributing to angst within CRE circles.

Traditionally, CRE owners would budget for a 2–3 percent annual increase in property insurance costs. However, 2023 witnessed a departure from this trend, with double-digit rate increases affecting multiple property types across the United States, including office, retail, residential, and industrial sectors. Barrons

NCREIF PROPERTY INDEX INSURANCE EXPENSES AS A SHARE OF REVENUE BY SECTOR UNITED STATES 2000–2024 Q2

While all sectors are affected by rising insurance costs, margin erosion is most significant in the multifamily residential sector. (NCREIF)



reported that "U.S. CRE expenses increased by more than one-third from 2017 to 2022. And insurance costs were up 73 percent from five years ago. Other expenses also saw increases, utilities by 40 percent, property taxes went up by 27 percent, and other operating expenses were up 29 percent. In contrast, the consumer price index only grew by 19 percent over the same period."[19]

While all sectors are seeing increased insurance costs, the most dramatic insurance increases are seen in the U.S. multifamily residential sector where insurance costs rose at almost twice the rate of total operating expenses during the 2021–2022 time period (see U.S. Property Insurance and R&M Expense Increases graph). Insurance expenses then continued to climb in 2023 (see Growth in U.S. Multifamily Total Expenses versus Insurance graph).

This surge in insurance costs was largely uniform across the United States, although properties at higher risk due to climate changes faced even steeper hikes. Specifically, Moody's found that the highest increases were in metro areas of Texas, the Sun Belt,

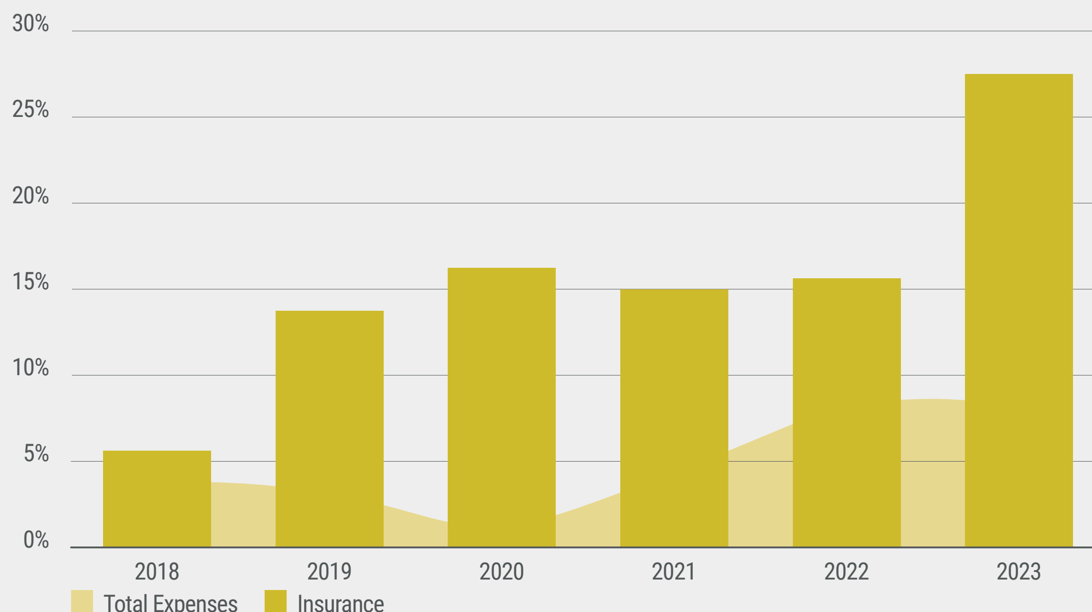
Total Growth of Multifamily Operating Expenses* from Dec. 2020–Dec. 2022
*"All Operating Expenses" includes "Property Insurance," "R&M," and all other expenses.

U.S. PROPERTY INSURANCE AND R&M EXPENSE INCREASES

Insurance for the U.S. multifamily sector rose at almost twice the rate of other operating expenses between 2021 and 2022. (First American, "CRE X-Factor – Why Operating Costs for Commercial Properties Have Soared")

GROWTH IN U.S. MULTIFAMILY TOTAL EXPENSES VERSUS INSURANCE

Insurance expenses have grown at a higher rate than total expenses.
(Yardi Matrix Bulletin Expense Growth Bedevils Multifamily)



the Northeast, and California, with the multifamily sector being the most severely affected. In their view, while many factors contribute to rising premiums, the predominant driver is the increased risk associated with climate change, particularly for areas prone to hurricanes. For example, in 2017, a 390-unit complex in Tampa had an insurance premium of approximately US$183,000. By 2022, the premium had risen to US$521,000, a 185 percent increase.[20]

Currently, the Asia Pacific region does not appear to be struggling with insurance cost issues in the adverse manner evident in the United States. One investment management firm indicated that insurance is a "very few percentage points of the NOI [net operating income]."

The European market has seen a significant recovery since the double-digit rate increase in 2020–2021. Rates have stabilized and increased capacity exists for noncatastrophe-exposed risks. Remnants of the hard market, such as agreement on specific terms and conditions of an insurer, continue to create challenges in finalizing coverage.[21]

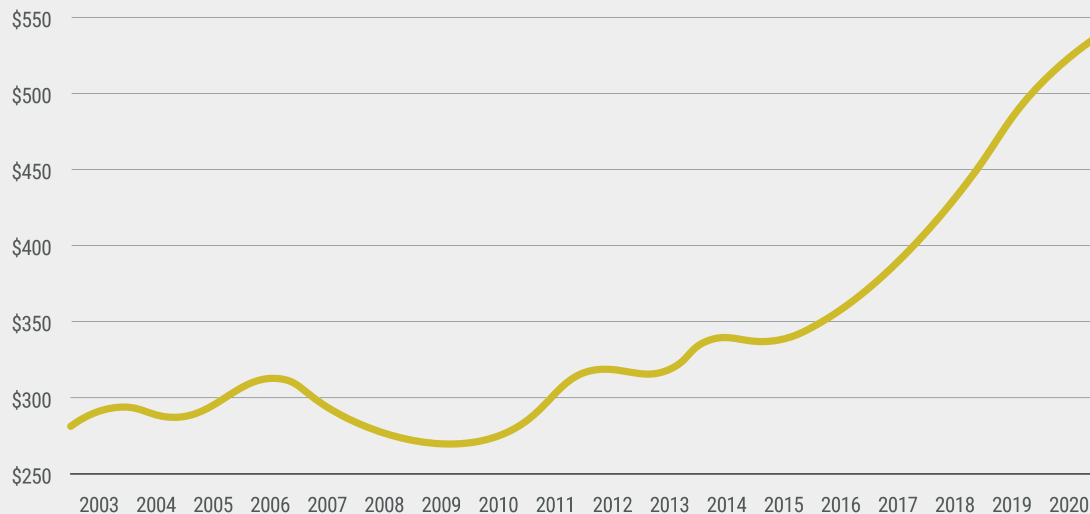
The Impact of Insurance Cost Increases on ROI, Valuation, and Transactions

The increase in insurance costs is becoming a notable concern for property owners in the United States, particularly due to its upward trend [see Average Multifamily Insurance Cost Per Unit (U.S.) graph].

The hard market environment is challenging the viability of investments, as noted by one U.S.-based investment manager, who pointed out the negative impact on return on investment (ROI) from rising costs—including maintenance, management, and insurance—are not being offset by increased rents. In Florida, an insurance broker highlighted a significant increase in per-unit insurance costs: "Three years ago,

AVERAGE MULTIFAMILY INSURANCE COST PER UNIT (U.S.)

Insurance costs rose dramatically in the multifamily sector.
(Matthews Real Estate Investment Services, "Insurance Costs Are Increasing – What Does That Mean for CRE?")



you were at $1,500-a-unit cost on a multifamily deal; now it's $5,000 a unit. It is hard to raise your rent in such a way to be able to support that."

Affordable housing providers in the United States whose rents are tied to inflation point out that "the growth in property premiums and insurance cost is dramatically outpacing inflation," leading to eroded profitability and hindering investment in the sector as well as the development of new properties. In Houston, a developer saw insurance premiums triple between 2020 and 2024. The developer planned to redevelop a motel-like property into new affordable housing units but now has to sell the property. "Our projected loss on our overall portfolio is now about $1 million. Not every property has always made money, but some properties were throwing off positive cash flow, and that could help to support properties that weren't. But the whole portfolio is basically losing money at this point. We can't go on like that."[22]

Even owners that have a triple net lease are sometimes seeing an impact on their returns. One investment manager with a U.S. portfolio explained that "our tenants are pushing back on our insurance increases that get passed back through triple net. We've had a lot of tenants who have reached out and questioned the justification for why the insurance is increasing so much . . . sometimes we acquiesce and do not pass back the full bore of it."

Interviewees also predicted that higher insurance costs would affect valuations, especially in areas with excessive insurance cost increases. Appraisers, however, model property values based off current insurance rates and will not predict future cost of insurance significantly off trend, leading one investment manager to consider valuation a longer-term impact: "the net effect [of rising insurance costs] is not many basis points yet in terms of how it's affecting our income yield. . . . But over time, we expect some impact on the residual value of the assets."

For most, insurance is an additional drag on NOI rather than the sole reason deals don't pencil. However, some transactions are being affected. One interviewee described their process of selling a Queensland, Australia, shopping center that had experienced

flooding in the past. The insurance premium rose 300 percent as a result—negatively impacting the final transaction price. A U.S.-based developer noted more dire circumstances for the rent-constrained affordable housing market, recounting that "there's been deals that we've not been able to make financially work because insurance is just so high for those properties." Another investment manager in the United States disclosed seeing "many asset sales fall apart" in the past 24 months due to increased insurance costs.

Changes in Terms and Conditions

The complexity of insurance costs in CRE goes beyond the upfront premiums. Policy buyers are navigating the nuances of their coverage limits, what their policies actually cover (or exclude), and the deductibles or retentions they must pay in the event of a loss, as well as the distribution of costs across multiple insurance carriers when large portfolios are involved.

North American property owners noted significant changes in terms and conditions in new policy contracts, particularly higher deductibles and reduced coverage. While upfront premiums are fixed costs, deductibles now represent an increasingly variable expense for investors. In this hard market, "the [deductible] percentages are significant, meaning the property owner bears a meaningful share of the loss."[23]

A critical component of property insurance policies—total insured value—is also being more deeply scrutinized. "I think that the lenders and the investors are just now getting to terms [with the fact] that the TIVs have been suppressed," remarked one insurance broker, who noted that it wasn't until the past few years that the insurance carriers began questioning the valuations and cautioned that if the "TIV was suppressed and you have a loss that is over that amount, they were now going to penalize you."

Interviewees expressed frustration at the complexities of assembling accurate statements of value, noting the dynamic nature of replacement costs and the difficulty in aligning these figures with insurers' assessments. Inadequate valuations can lead to insurers imposing coinsurance and modifying liability limits. "Claims adjustments can also be harder to fulfill if the loss measurement is higher than reported values."[24]

One specific practice highlighted is the adoption of occurrence limit of liability endorsements (OLLEs) or margin clauses by insurers. These provisions restrict the insurance payout to the reported value of the building, thus not covering the full extent of the loss if the value was underreported. One investment manager shared that they had been "hit" with a margin clause. Fortunately for that manager, the margin clause was lifted after valuations were updated, renewing access to full policy limits on losses and significantly simplifying dealings with lenders.

The Influence of Lenders in the Insurance Equation

"The hard property market has presented situations where increased deductibles, limitations on coverage

MARGIN CLAUSES

A margin clause in an insurance policy limits how much a property may increase in insurable value during the policy period (typically one year) from what was originally declared in the statement of value. The margin may be stipulated as a growth percentage or as a value percentage, such as 120 percent of the stated value of insured assets.

This clause is in addition to the coinsurance penalty for underinsuring a property.

terms, and property limits may no longer follow the requirements outlined in leases, loans, or contracts. There have been situations where the requirements outlined in these agreements are no longer commercially available or are cost prohibitive to an insured,"[25] cautioned one insurance broker.

"THE HARD PROPERTY MARKET HAS PRESENTED SITUATIONS WHERE INCREASED DEDUCTIBLES, LIMITATIONS ON COVERAGE TERMS, AND PROPERTY LIMITS MAY NO LONGER FOLLOW THE REQUIREMENTS OUTLINED IN LEASES, LOANS, OR CONTRACTS."

The ramifications of these dynamics extend significantly to affordable housing developments. Here, increased insurance escrow payments have often driven borrowers to breach loan debt-service coverage ratios and have forced some property owners into making lump-sum payments to address insurance escrow shortfalls.[26]

Market-rate condominiums are also being impacted. As an example, 400 condos in Hawaii have less than 100 percent insurance coverage after facing premium increases between 300 and 1,300 percent in a single year. Because full replacement coverage is essential for mortgage approval, as mandated by Fannie Mae and Freddie Mac, many buyers will not qualify. Furthermore, only four standard insurers offer condo policies in Hawaii, forcing associations to seek costly alternative financing options to meet the coverage requirements, significantly impacting affordability and accessibility for buyers.[27]

Property owners and insurance brokers are equally frustrated by what they view as lenders' conservative approach. One insurance broker said, "I have a client that is required to buy $50 million in named wind limits, but the catastrophe models say they only need to buy $10 million as there's a 99.8 percent [chance] that they will never go over a $10 million loss. The cost to buy that $50 million in named wind coverage—versus $10 million—is millions of dollars of premium and can be the difference between a cash flowing deal and a deal going into foreclosure." To navigate this mismatch, property owners and their insurance brokers "easily spend hundreds of hours on the phone providing documentation and analysis on the [limited impact of a] one-off 100-year event for a property," according to one insurance broker.

Another insurance broker suggested that "lender insurance requirements are so overly conservative, and not in alignment with reality, that it's causing some of the supply demand issues in the [property insurance] market."

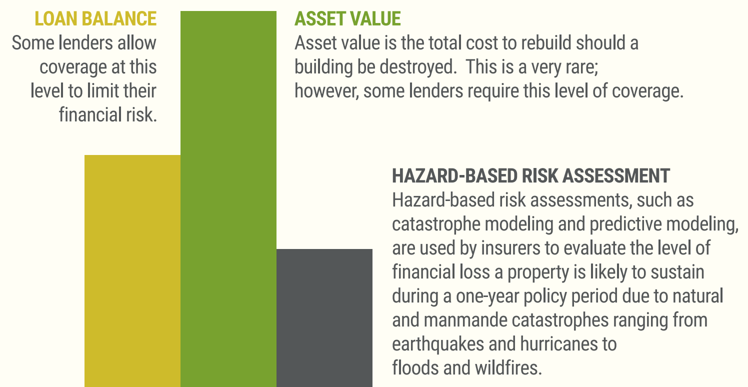
THE OVERLOOKED IMPACT OF LENDERS' INSURANCE REQUIREMENTS ON PROPERTY INVESTMENTS: HEITMAN'S PERSPECTIVE

Property investors are increasingly considering climate risk and resilience in their investment decisions. In estimating insurance costs, investors often follow the guidance of insurance brokers, using hazard-based risk assessments to determine coverage needs. However, many investors may not be considering insurance requirements imposed by lenders. Lender-imposed insurance demands often exceed the recommendations from brokers' hazard-based risk assessments (see Insurance versus Lender Requirements graphic), leading to higher-than-expected insurance costs for borrowers.

Large, traditional lenders typically require comprehensive insurance coverage that surpasses the actual risk exposure calculated by hazard-based risk assessments used by insurance companies. This conservative approach drives up insurance costs, reducing a property's net operating income and overall profitability. While such lender insurance requirements are not new to the CRE market, their economic impact has intensified due to higher deductibles and rising insurance premiums, forcing investors to adjust their strategies, seek alternative lenders, or even reconsider certain investments.

LEVELS OF INSURANCE: LENDERS VERSUS INSURERS

The cost of insurance is greater the larger the percentage of total insured value (TIV) that is insured. Lenders and insurers often have different views on what level of coverage is required. (Rose Geier Grant)



While stringent insurance requirements from traditional lenders may offer more financial security after a catastrophic event, the higher lender requirements could also significantly shift market investment activity, particularly away from those regions that are vulnerable to heightened physical climate risks. The difficulty in securing insurance that meets strict standards could lead to reduced investment activity and lower market liquidity.

As an alternative, smaller, private lenders are increasingly incorporating hazard-based risk assessments into their insurance coverage requirements. This more flexible approach could make private debt providers more attractive to investors, allowing them to gain market share over traditional lenders.

The evolving landscape of lender insurance standards could play a crucial role in shaping the future of property investment, especially as climate risks continue to rise. Lenders who maintain excessive insurance requirements may find themselves at a competitive disadvantage, while those who align their requirements with advanced risk assessment tools could attract more investments. Conversely, property owners unable to find affordable and adequate insurance coverage may be forced to make different investment decisions, potentially shifting the dynamics of real estate markets.

Obtaining Coverage While Managing Rising Insurance Costs

In the face of these challenges, availability of coverage is not the foremost issue for investors in the CRE market; rather, the difficulties lie in securing affordable policies that will not adversely impact investment performance while providing adequate risk coverage. As one insurance broker put it, "We are in an insurance market where the cost to transfer risk to an insurance carrier isn't always an efficient cost of capital."

"WE ARE IN AN INSURANCE MARKET WHERE THE COST TO TRANSFER RISK TO AN INSURANCE CARRIER ISN'T ALWAYS AN EFFICIENT COST OF CAPITAL."

To manage rising premium costs and shrinking coverage, property owners are adopting various strategies. These range from straightforward approaches such as layering coverage or opting for a higher deductible, to alternatives such as aggregate deductibles, self-insurance, self-insured retentions (SIRs), captives, parametric coverages, and/or leveraging excess and surplus lines (see Strategies for Securing More Affordable Insurance Coverage graphic). Each of these mechanisms offers distinct advantages and suits different risk management needs, reflecting a more nuanced approach to risk than traditional insurance products.

To be successful, interviewees advised starting insurance renewal discussions early, especially for larger portfolios, and working closely with insurance brokers who understand one's business needs.

STRATEGIES FOR SECURING MORE AFFORDABLE INSURANCE COVERAGE

Investors are using a variety of insurance products and tactics to manage rising insurance premium costs. While all strategies are applicable to portfolio- or asset-level coverage; self-insurance, self-insured retention, captives, and multiyear policies are most applicable to portfolio-level coverage.

Layered Coverage: A Must for Large and High-Value Portfolios

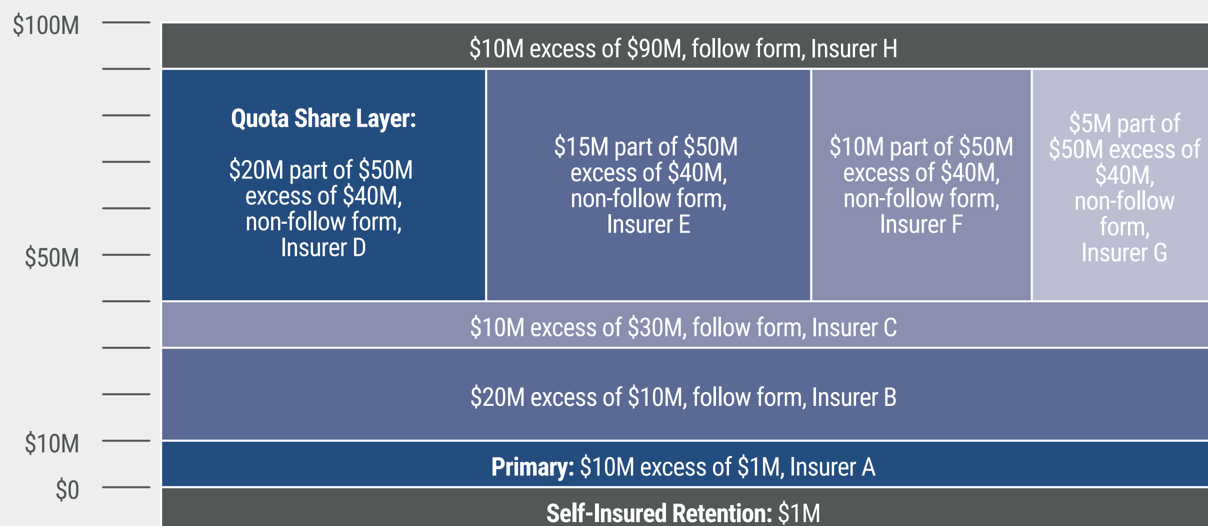
"The process around marketing or placing coverage for a client is markedly more time-consuming and takes many different approaches. Five-plus years ago you went out to the insurance marketplace, competed [insurance] carriers against each other, and provided that result to your client," reflected one insurance broker. Now, the process is much more complex, often requiring property owners and their insurance brokers to stitch together coverage from multiple insurance carriers. Another insurance broker lamented that in the past, he would receive quotes from 45 different insurance carriers and was able to leverage the negotiations to his advantage. In 2023, he tried for 36 quotes but ended up with only 29 and "had to go beg two or three people that declined and that's why the pricing was so bad."

One strategy interviewees are leveraging is the consolidated master program, which involves different carriers taking different layers, or portions thereof, of the ultimate risk exposure, similar to lenders taking different debt tranches in the financial markets (see Example of Layers within an Insurance Tower graph). This can lead to dozens of insurance carriers being involved in a single coverage plan. One investment manager expects up to 36 layers in its program and potentially involving up to 100 insurance carriers, including syndicates. Master programs can be structured as concurrent insurance solutions where insurers each provide coverage based on their quota share (single policy or within a layer) or through a layered approach.

Additionally, a buffer layer can be employed to manage risk. This involves securing additional policies to cover specific loss windows above the primary coverage limits, such as acquiring extra protection against

EXAMPLE OF LAYERS WITHIN AN INSURANCE TOWER

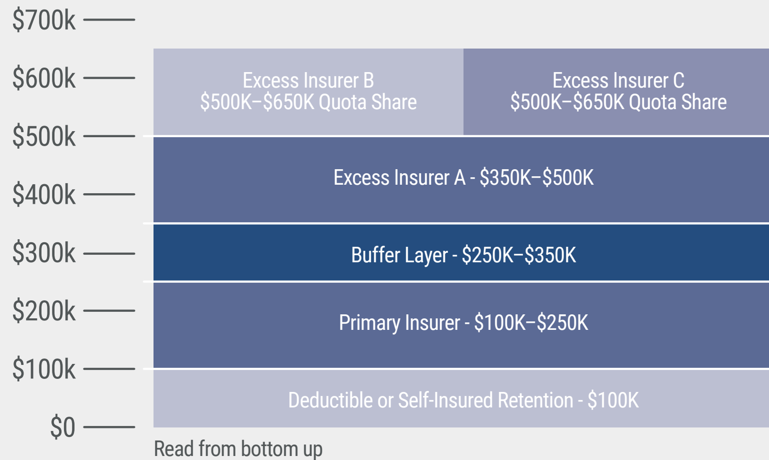
Large insurance policy limits are typically built from many layers from various insurance carriers. A layer is defined as the amount of insurance coverage in place. Layers can be serial or parallel and multiple insurance carriers can take part in a single layer. Each insurance carrier or group of insurance carriers are only responsible for paying out losses within their layer. The primary insurance carrier (Insurer A) will pay out first, followed by excess insurance carriers B and then C. Insurers D–G would each provide a portion of the payout based on their quota share. These structures help insurers manage their risk and help policyholders secure more affordable coverage as the price per unit of capacity typically drops at each successive layer. (Axio, "Modern Insurance: Overview and Structure")



Read from bottom up

EXAMPLE OF A BUFFER LAYER

This illustration shows how a buffer layer works. The top levels of excess coverage in this insurance tower only cover losses starting at $350,000. The difference between the excess coverage policies and the maximum payout of the $250,000 primary insurance coverage is $100,000. The policyholder could assume liability for that amount of loss or obtain a buffer layer policy of $100,000 from another insurer to cover the expected loss. (Rose Geier Grant)



natural disasters when the primary policy's limits are exceeded, but with a clear demarcation of liability for losses within certain thresholds (see Example of a Buffer Layer graph).

These complicated coverage packages illustrate the measures companies are undertaking to navigate the complexities of the current insurance market and may also include unique risk allocation structures such as higher deductibles, self-insurance, and captives—as discussed in the following sections—in addition to multiple layers of coverage.

Navigating Deductibles to Manage Overall Insurance Costs

The first strategy many property owners adopted to manage rising premiums was a higher deductible; essentially accepting a greater portion of risk themselves. This might look like a shift from a US$1 million deductible to a US$5 million deductible. As one insurance broker explained, "I'd rather hold that risk on my balance sheet and bet on my ability to manage my risk over the course of three to five years and save 50 percent." The broker saw this as an effective method to offset insurance pricing volatility.

Others are implementing aggregate deductibles. This approach applies a single deductible to all claims within a policy period rather than traditional per-occurrence deductibles. This structure benefits policyholders by limiting out-of-pocket expenses to a predetermined amount regardless of the number of claims, promoting cost predictability and potentially reducing premiums due to lessened small claim filings. One insurance broker mentioned that their U.S.-based clients were using aggregate deductibles more frequently, and at a higher deducible amount.

While higher deductible policies can be more affordable, those higher deductibles, as well as reduced overage limits, may be in conflict with lender requirements. For smaller firms, policies that cover deductible costs, known as deductible buy-down policies, are an option to manage financial exposure from disasters more effectively. A deductible buy-down policy has its own (much smaller) deductible and premium; enabling an insured to make up the difference between the lender's requirements and the most cost-effective deductible.[28]

Self-Insurance: Putting Skin in the Game

> "Where the real estate market is troubled and insurance costs are stripping cash flow out of properties and decreasing NOI, a client will do anything they can to reduce expenses."
>
> **INSURANCE BROKER**

As property owners navigate an increasingly difficult insurance marketplace, they are considering alternative options such as self-insurance or captives to manage their insurance expenses more effectively and affordably. As one investment manager/affordable property developer noted: "We are self-insured at two of the higher levels in the [insurance] tower simply because of price; it was getting out of hand."

Self-insurance requires that companies directly assume a portion of the risk. This can be managed passively, through straightforward allocation of losses against retained earnings or cash flow, or actively, via dedicated loss reserves. Similarly, self-insurance pools allow collective risk management among similar entities, offering another layer of flexibility.

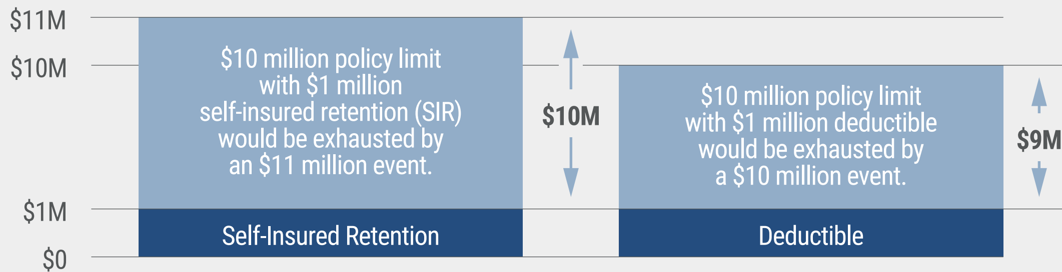
As property owners increasingly adopt self-insurance for higher layers of coverage, they are evaluating the balance between potential losses and premium savings. One investment manager went as far as developing several retention scenarios to present to their insurance carrier to see how they would affect the premium. The question they asked themselves was "What are estimated losses that we think we'll have in that layer versus the premium savings that we'll get by not insuring it?" The company, with approximately US$2 billion assets under management, settled on retaining a total of US$2.5 million in potential losses, with individual properties in the portfolio exposed to a maximum of US$100,000 each. This type of bold gamble is seen as necessary given the large increases in insurance costs.

However, self-insurance does present challenges for investors that must observe legal and regulatory prohibitions against commingling funds. Lenders expressed concern about balance sheet impacts, especially within the real estate sector. This underscores the importance of tailored risk management strategies that consider specific organizational constraints.

Self-insured retention and captive insurance represent other forms of self-insurance, as opposed to a typical deductible (see The Difference between a Self-Insured Retention and a Deductible graph). A SIR is when an insured assumes responsibility for a specified amount

THE DIFFERENCE BETWEEN A SELF-INSURED RETENTION AND A DEDUCTIBLE

With a $1 million SIR in place, the insured is required to make payments first and the insurer only begins to make payments once the SIR is satisfied. With a $1 million deductible policy, the insurer pays for and adjusts the losses and then collects reimbursement afterward, up to the amount of the deductible. (Axio, "Modern Insurance: Overview and Structure")



of losses. In a SIR, losses are paid for and handled by the policyholder, up to the retention limit, before insurance is triggered. This means that the policy limits are not reduced as they would be with a deductible.

Captive insurance companies are highly regulated entities as they are legally incorporated insurance companies. The difference is that they are owned by their only client. Captives are typically formed by large, well-capitalized organizations. The risk is covered by a formal insurance policy from the captive insurer for which the insured is required to pay a fair premium—defined as an amount adequate to cover claim payments, operating expenses, and a return on capital—for the covered loss.

While only one interviewee—a U.S.-based developer, owner, and investment manager—had a captive in place, a recent survey of NAREIM members found that almost a third of investment managers were considering self-insurance or the use of a captive to address the increased cost of property and casualty insurance.

One investment manager questioned whether a captive might be the best solution for property losses. They examined their losses for the prior five years and concluded that "the captive is probably the worst program that we can put in there for a property program." In their experience, captives work well for Workers' Compensation or General Liability, where there is time for capital to accumulate in the captive since those losses are generally paid out over many years. In contrast, when it comes to property loss, the increasing frequency of extreme weather events may limit the amount of time capital has to accumulate in the captive. Thus, captives may not be feasible for firms with less than $5 million in annual premium volume.[29]

CAPTIVE INSURANCE VERSUS SELF-INSURANCE

Captive insurance is when a business owner sets up an insurance *company* to insure its own risks, while self-insurance is when a business owner assumes all financial responsibility for potential losses (partially or in total).

Multiyear Policies

The insurance sector's practice of annually adjusting premium prices adds layers of complexity to investment calculations for properties with longer-term holds. Many investors remarked that they would welcome a multiyear property insurance policy; however, such policies are "very rare," according to an APAC-based insurer, and are dependent on building quality and claims history. Only one manager, based in Europe, reported a renewable policy solution. The policy was conditional on not exceeding certain established loss thresholds and had mutual nonrenewal options.

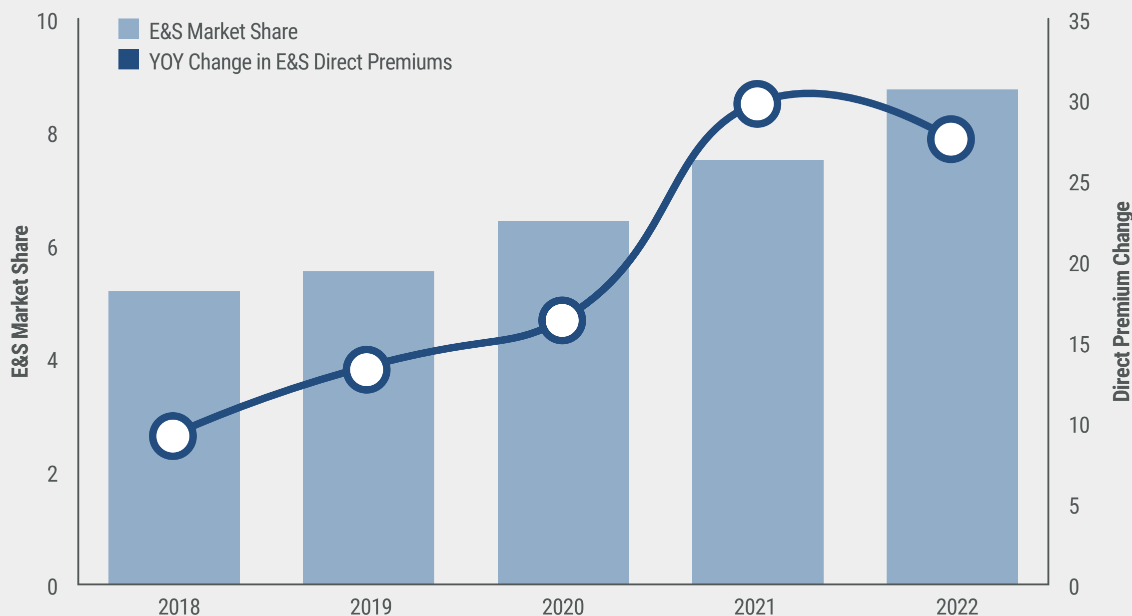
Another investment manager investigated using an alternative risk transfer (ART) program that would have included a three-year renewal provision. The financiers were investors, not insurers, and were unfamiliar with the insurance concept of "earned premium." With a high volume of transactions, adding and selling properties, there would be times that unearned premium should be returned to the management firm, but the financiers were unwilling to structure the program to include return of unearned premium on properties that had been sold.

Solutions for Hard-to-Insure Properties

Excess and surplus (E&S) line coverage is an insurance product designed for high-risk exposures traditional insurance carriers won't cover. It is only available from specialty carriers. The use of E&S lines for insurance placement is increasing, particularly as admitted insurance carriers in the United States encounter difficulties in catastrophe-prone states. This shift has made E&S insurers a vital alternative for coverage, with their market share surpassing 9 percent of direct written premiums in 2023 (see E&S Premiums as a Share of the U.S. Property and Casualty Market graph).

EXCESS AND SURPLUS (E&S) PREMIUMS AS A SHARE OF THE U.S. PROPERTY AND CASUALTY MARKET

E&S premiums account for an increasing share of the U.S. property and casualty market. Data includes all E&S lines, not just commercial property. (S&P Global Market Intelligence)



Insurance brokers note that for multifamily risks, especially in coastal areas where superior construction is lacking, use of E&S line coverage is more prevalent. A growing concern is that property owners may have to look to E&S providers for coverage against secondary perils, such as severe convective storms (see page 31), notably in hail-prone areas or for properties with vulnerable features, like solar panels on roofs.

An Innovative Product for Catastrophe-Prone Regions: Parametric Insurance

Parametric insurance introduces a model that pays out based on the occurrence of predefined trigger events, rather than the losses incurred. For example, with a parametric wind cover policy, the trigger is normally "a sustained wind of Category 3 and above for a sustained period of 1 minute within a defined radius."[30] As long as the storm passes through the designated area, it will trigger coverage and the policy will pay the stated limit. This type of insurance is gaining traction for its straightforwardness in event-based risk scenarios, such as earthquakes, windstorms, riverine flooding, and hail, offering clear terms for coverage activation.

A European insurance broker noted that parametric insurance was used in Pontypridd, Wales, after the area experienced flooding in February of 2020 and insurers refused to write full flood risk. As a new solution, parametric insurance is not yet widely adopted by the real estate industry. One large investment manager shared that he's "socialized it with management" and anticipates having to use parametric insurance "in the next three to five years because of capacity." However, he also acknowledged that, "It's going to be an even steeper hill to climb just in terms of getting [lenders] comfortable with a parametric."

Embrace Information Sharing with Insurance Teams

Securing insurance has become more time-consuming as underwriters require more detailed information. For example, a U.S.-based investment manager was asked for data specific to building performance for windstorms. She worked with a third-party vendor to review the building's construction documents and ensure that the data provided was correct. While the investment manager could not definitively say that the effort resulted in lower rates or additional capacity, she does believe that it helped "tell the story that we're somebody that they want to insure."

For another firm, proactively sharing resilient design information with insurance carriers helped reduce premiums for one of its developments in Florida. The first quote from the insurance carriers was "quite a shock," but in working with them and describing the asset's resilience features, the second quote came back in a more acceptable range.

One critical piece of data is the roof's age, as it significantly influences vulnerabilities to wind and water damage, affecting insurance coverage and premium calculations. A Verisk report found that inaccurate or missing roof age information resulted in US$1.31 billion in annual premium leakage. Premium leakage refers to the loss of revenue due to policyholders not paying their full insurance premiums. Like TIV undervaluation, this results in economic loss to the insurer and can drive up premiums. This data is so important that property owners can be at risk of having their commercial roof damage claims denied if the roof age is inaccurately stated.[31]

While tedious to acquire, this information helps the insurer and highlights attributes that put the structure in a better position from a risk underwriting perspective. Where the evidence isn't clear to prove otherwise, insurers will quote more conservatively, leading to increased premiums.

WHERE THE EVIDENCE ISN'T CLEAR TO PROVE OTHERWISE, INSURERS WILL QUOTE MORE CONSERVATIVELY, LEADING TO INCREASED PREMIUMS.

Stakeholder Communication Is Key

Managing insurance costs effectively involves cultivating strong relationships with pivotal industry stakeholders, including lenders, regulators, and investors. Traditional insurance brokers remain essential in navigating the complexities of commercial insurance programs and are particularly helpful in coordinating the multiple insurance carriers typically engaged in providing coverage. Some interviewees are also using third-party consultants to navigate the changing insurance landscape. Others rely on in-house insurance experts to navigate the increasingly complex process of securing affordable coverage. Almost two-thirds of NAREIM members have dedicated internal real estate insurance teams.

Regardless of who the stakeholders are, it's critical to create a structured process with each party to ensure the highest quality of data and maintain open lines of communication. One insurance broker emphasized that "the lack of proactive, consistent communication and transparency within the various stakeholders in the transaction is what causes a lot of issues."

"THE LACK OF PROACTIVE, CONSISTENT COMMUNICATION AND TRANSPARENCY WITHIN THE VARIOUS STAKEHOLDERS IN THE TRANSACTION IS WHAT CAUSES A LOT OF ISSUES."

As affordable insurance coverage becomes more complex, additional time is needed to not only secure coverage, but also to communicate the rationale for decisions to lenders and investors and, in some cases, develop alternative solutions. One investment manager explained that confirming their insurers were comfortable with the methodology used to calculate their TIV could mean the difference between being hit with a margin clause or not having one. Another key discussion point was explaining how deductibles have increased: property owners have received significant pushback from lenders after conveying that they were facing higher deductibles because their historical US$10,000 deductibles were no longer available in the market. One team eventually settled on a deductible buy-down policy to reduce the deductible to an acceptable level.

Navigating Investment Decisions and Building Management in an Era of Insurance Uncertainty

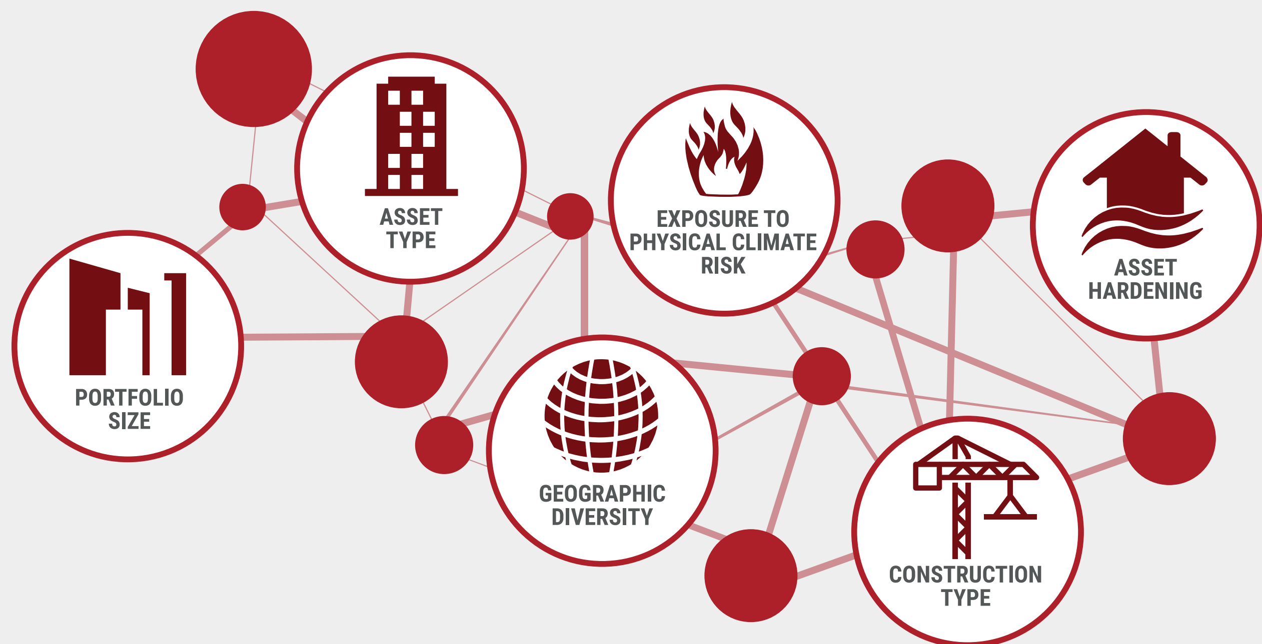
While rising insurance costs and coverage constraints, particularly in high-catastrophe geographic areas, have become a significant concern among investors, the higher costs have not deterred them from investing in these markets. They are, though, carefully reassessing the feasibility of new investments in areas prone to environmental risks and crafting their portfolios accordingly. The quickly evolving insurance market has also brought new cautions and opportunities for specific asset classes and has emphasized the need for both proactive building maintenance and investment in resilience (see Investment Considerations That May Influence Insurance Pricing infographic).

Portfolio Size and Diversification Matter

Managers found that leveraging a portfolio's size and diversification across geographic regions and asset types could make their policies more attractive to

INVESTMENT CONSIDERATIONS THAT MAY INFLUENCE INSURANCE PRICING

Asset and construction type, exposure to physical climate risks, and asset-level hardening may affect insurance pricing and thus are heightened considerations for investors. The size and geographic diversity of an investment portfolio can also influence insurance premium costs.



THE COPE PRINCIPLE

Insurance underwriting heavily relies on the COPE principle, which stands for analyzing **Construction**, **Occupancy**, **Protection**, and **Exposure**, to assess risk.

insurers. "We feel like our buying power has been a benefit, and that we're a big enough portfolio to go and get coverage for all of it; we present it as an all-or-nothing proposition," reflected one investment manager.

While size matters, insurers also value geographic diversity. Exposure, a critical element of the COPE principle (described above), stems from proximity to hazards, whether from exposure to hazardous chemicals or to natural disasters such as hurricanes, earthquakes, and wildfires. Geographical diversity across a portfolio can spread exposure risk, limiting the likelihood of a single hazard event affecting all or a large portion of an investor's assets, which would result in an excessively large loss for insurers.

As a strategy to obtain price-palatable coverage, some investors have begun to exclude some high-risk properties from their portfolios and secure separate insurance coverage. However, the strategy of maintaining a geographically diverse portfolio was the most common among interviewees.

Beyond leveraging geographic diversity to moderate insurance prices, investors are also wary of climate change impacts on their portfolios. One investor noted that "physical climate risk is a clear component and maybe I would argue one of the primary drivers of how we're thinking about where we go next from a geographic perspective."

Structure and Maintenance Considerations

Construction type is a key component of the COPE principle; as such properties built with wood-frame construction may face additional challenges in obtaining coverage. One broker interviewed stated, ". . . wood frame, it's been very problematic. The first thing I do every morning is turn on the news to see what apartment complexes have burned down . . . it's going to limit the carrier appetite." Indeed, major insurers, such as Zurich, provide only US$25 million in maximum coverage for wood frame as compared to US$75 million for "superior construction."[32]

In Northern California, an affordable housing provider facing tough margins shifted from wood-frame to concrete construction to reduce costs from growing insurance premiums. "The pricing on construction goes up by US$2.5 million, but our construction-period insurance premiums come down," said the housing provider. "It's cheaper to change the construction than it is to buy the insurance is the bottom line."

In addition, insurance carriers may decline coverage if properties have inadequate maintenance, aging roofs, outdated electrical systems, or lack a fire-suppression system, highlighting the importance of regular property maintenance for securing insurance.

A U.S.-based national insurance and financial services firm noted that "insurers are reserving their full capacity for best-in-class accounts, many insurance carriers will renew [not best-in-class] existing accounts at the same limits and coverage terms but will resist offering additional capacity or more favorable terms."[33]

Asset Type Cautions and Opportunities

The tendency of multifamily properties to be wood-frame construction combined with the habitational risks—such as cooking and bathing—inherent within a multifamily property makes that asset class more expensive and more difficult to insure than other occupancy types. According to the National Multifamily Housing Council's 2023 report, a majority of insurers

have introduced policy limitations, and 60.6 percent of policyholders have been forced to increase deductibles. Despite these challenges, one investment manager pointed out that "the ability to obtain insurance is a big and growing question likely to impact homeowners first. In the short run at least, this could be a net benefit to rental housing."

The owners of buildings with fixed-rent commercial leases also struggle to adapt to escalating insurance costs; even with a step-up lease in place, rents may not be able to keep up with the premium increases. This contrasts sharply with the flexibility insurers have to adjust rates annually. Unsurprisingly, investors see opportunities to invest in net-lease properties that allow the asset holder to transfer some risk, at least in the initial lease agreement, to the tenant.[34]

"Struggling office owners with significant vacancies are also paying more for insurance, and for general maintenance and the security needed to protect empty spaces," according to a real estate services consultant.[35] Individual insurers treat vacancies differently, but after a specified amount of time (30 to 60 days), they may totally exclude damage from certain causes of loss, such as theft, water damage, or vandalism.

Cautiously Bullish

Investors admit that while insurance concerns have increased compared to five years ago, they have not deterred investments in high-risk areas. Rather, concerns are spurring greater emphasis on anticipating and mitigating insurance-related costs and limitations.

Investors have yet to identify a reliable way for predicting insurance costs, though some are piloting methodologies they hope will pay off. For example, one investment manager described an internally developed "CAT Score" to help the portfolio managers better understand when an asset may be subject to a premium surcharge due to its location. That data is then extrapolated to assess what the additional cost will be over their hold period.

Another investment manager disclosed that they "build in an inflationary factor for insurance rates that's lower than what we've seen in the past few years, because there's a strong belief that all capital markets moderate themselves, and so at some point, insurance will become more like in the past." The investment manager does "build in losses anticipated for coastal properties that will not be covered by insurance costs," but closed by stating "they're probably underestimating."

THE INVESTMENT MANAGER DOES "BUILD IN LOSSES ANTICIPATED FOR COASTAL PROPERTIES THAT WILL NOT BE COVERED BY INSURANCE COSTS," BUT CLOSED BY STATING "THEY'RE PROBABLY UNDERESTIMATING."

Yet another investment manager disclosed a growth factor of "somewhere between 5 and 10 [percent] generally," but that, "in the short run, that's probably too conservative."

One investment manager is strategizing around not just the cost of property insurance, but also the rise in social inflation, studying the locations of particularly litigious venues like "Northern and Southern Florida versus middle of the state, Florida . . . or Austin, Texas, versus Dallas, Texas," in an effort to moderate rising insurance costs. As another investment manager noted, "There are areas that are just highly litigious and unfriendly court systems for landlords."

Stepping back from insurance premiums alone, another investment manager explained that "we don't think of insurance as a standalone thing. We look at losses. We are going to pay for all of the losses, either through insurance or self-insurance. When we look at the potential losses, that's where there's deals that just don't make sense because we're not going to make any money during the entire operating life cycle."

Disposition Strategies and Considerations

When it comes to disposition, interviewees did not cite insurance costs alone as a reason to sell. However, one interviewee noted that "as loss history is becoming a greater factor in our own insurance numbers, the idea that a property that experiences a loss event might rise on my sale list is something that is sort of a new topic."

Many interviewees expressed concern over "the next buyer" and what insurance availability and costs may be when it comes time to dispose of that asset. One investment manager pointed out that while large-scale investors might not face difficulties in securing insurance coverage due to their ability to negotiate or consolidate coverage across a portfolio, individual buyers could struggle, potentially narrowing the buyer pool and affecting the property's sale price.

WHILE LARGE-SCALE INVESTORS MIGHT NOT FACE DIFFICULTIES IN SECURING INSURANCE COVERAGE . . . INDIVIDUAL BUYERS COULD STRUGGLE, POTENTIALLY NARROWING THE BUYER POOL AND AFFECTING THE PROPERTY'S SALE PRICE.

Beyond the cost of insurance, the overall strength of the market remains a consideration. For example, one firm especially concerned with beach erosion and flooding (in Florida), has begun to view transactions in terms of "Will capital be attracted to this area over the next five to 20 years?"[36] A European interviewee was more dismal, predicting high-risk areas will see a "reversal of capital flows within the next 20 years."

When the Private Insurance Market Walks Away

Between 2023 and 2024, homeowners insurance providers exited several troubled markets in the United States, while other countries saw coverage evaporate for certain risks or in specific locations. And, while insurance coverage is still available for commercial real estate properties, one investment manager explained that "the concern is, the insurance market can be fleeting. It doesn't take much for them to enter a market or to leave a market."[37]

The uncertain availability of insurance weighed heavily on the minds of many interviewees, with one investment manager expressing that they are trying to stay "one step ahead of the insurance industry; we don't want to be heavily laden with Texas assets or Florida assets or California earthquake, if all of a sudden we see a big pullback in terms of capacity."

The Value of Resilient Buildings

Insurers were keen to articulate that "relying only on insurance as a risk-management strategy, especially when it comes to natural hazards, is not enough." In Hong Kong, an insurer admitted that the risk-reduction actions their clients took were "one of the very important things that made the 2023 black rain event less of an economic impact for us." In theory, these reduced claims should benefit the policyholder. However, property owners are not seeing insurance carriers consistently take proactive risk-reduction upgrades into account in pricing.

"RELYING ONLY ON INSURANCE AS A RISK-MANAGEMENT STRATEGY, ESPECIALLY WHEN IT COMES TO NATURAL HAZARDS, IS NOT ENOUGH."

That may be changing. A large insurer noted that "the customers that were doing the right thing to begin with saw much smaller rate increases." Similarly, a global insurance carrier stated that they "absolutely look at all physical protection, whether it's for wind with hurricane shutters or whether it's for flood doors or flood walls for flood. In an earthquake, in California, we look for sprinkler sway [to prevent breakage and water leakage]. We look for every physical protection. And we use that in our evaluation of the asset." Another prominent global insurance broker shared that his firm is actively working to "understand the insurance-based implications of specific high-risk areas within a portfolio in order to price it independently." The broker believes that this approach will enable the firm to assess the cost-effectiveness of measures that could lower premiums.

Timing within the hard-soft cycle may also play a role in insurance carriers' willingness to value resilience strategies. One insurance broker revealed that "as a soft market moves in, you start to see insurance players be more competitive on their terms . . . not just premiums changing, but also things like risk management credits becoming much more popular."

"AS A SOFT MARKET MOVES IN, YOU START TO SEE . . . NOT JUST PREMIUMS CHANGING, BUT ALSO THINGS LIKE RISK MANAGEMENT CREDITS BECOMING MUCH MORE POPULAR."

In the meantime, an investment manager advocated for investing in newer properties built to current, stricter building codes as a strategy for resilience. It's acknowledged that certain construction methods and materials inherently improve resilience (as in concrete versus wood-frame construction). He believes that upgrades such as new roofs and windows will be recognized by insurers, potentially leading to better premium terms.

Insurance Incentives for Investing in Risk Reduction

Although the market offers limited options for guaranteed premium credits for CRE properties, two programs have been designed that might lead to more optionality for property owners: FM Global's Resilience Credit program and the Insurance Institute for Business and Home Safety (IBHS) FORTIFIED Commercial™ and Multifamily programs.

Under FM Global's program, clients receive a 5 percent premium credit to offset the costs of implementing climate-resilient solutions, such as flood protection, wildfire reduction measures, and roof reinforcements to withstand extreme weather conditions.[38] One global insurer interviewed anticipates the market will see more of these resilience credit programs in the future, and another international insurance broker is already starting to see the use of resilience premium credits to support flood risk improvements or hurricane protection.

TYPES OF INSURANCE INCENTIVES

Premium credits are paid in the form of a credit against future premiums.

Premium discounts are immediate reductions in premium costs for policyholders who meet certain criteria.

These incentives lower insurance costs by encouraging responsible risk management.

The IBHS FORTIFIED Commercial program offers a designation to U.S. commercial buildings, such as offices, retail spaces, hotels, storage facilities and others. A separate program, FORTIFIED Multifamily™, has been developed for multifamily properties. These compliance and designation programs require plan reviews, site evaluations and adherence to a set of enhanced design standards aimed at minimizing damage from hurricanes, tropical storms, and severe convective events.

While discounts vary by carrier and by location, several U.S. states offer some level of insurance premium discounts for commercial buildings that could receive the FORTIFIED Commercial or Multifamily program designation:

- Alabama provides commercial property owners statewide with a premium discount.
- Florida grants premium discounts through its Hurricane Loss Mitigation Retrofit Grant fund.
- Premium discounts are available for properties insured by the Mississippi Windstorm Underwriting Association.
- Louisiana created a regulatory process for insurers to, on a voluntary basis, file for premium discounts/rate reductions for commercial buildings.
- Georgia requires property insurers to provide premium discounts for commercial structures that are built or retrofitted to resist wind damage.

While commercial discounts may not be specifically listed for a state, insurers may accept IBHS certification as proof of resilient design and provide premium credits or discounts accordingly.

On the Horizon: Trends to Watch

While hard markets will inevitably soften to some degree, the insurance sector remains vigilant, with property insurers actively fine-tuning their portfolios for enhanced profitability and stability, amid the looming threat of unforeseen global risks and the rising impact of secondary perils.

For investors, continued market signals suggesting higher insurance costs and ongoing threats to insurer profitability could create knock-on effects that reshape the desirability of currently hot markets in areas with growing hazard exposure. Lenders too could begin to see physical climate risk hit their bottom line—and may price those risks accordingly.

Climate Trends: The Rising Costs of Secondary Perils

Traditionally, primary perils like floods, earthquakes, and hurricanes have been a focus in the insurance sector, as they are known to cause substantial losses. However, in 2023, primary perils only accounted for about 14 percent of global losses. Secondary perils—small or midsized events following a major catastrophe or smaller, more frequent events—have become a significant concern. These are often not covered by reinsurance, leading to increased out-of-pocket expenses for direct insurers and eroding underwriting profits, leading to premium increases. One insurance broker described secondary perils as causing "death by a thousand cuts" to insurers.

In 2023, the insurance industry faced unprecedented challenges due to severe convective storms (SCSs). These thunderstorms, characterized by heavy rain, intense winds, tornadoes, and hail, have become more frequent and severe, causing substantial financial impact (see Top 10 Costliest Severe Convective Storm Events table). Aon reported that SCSs accounted for approximately US$70 billion of insured losses globally, or 59 percent of losses from all natural disasters. This continues a trend of growing SCS-related losses, with Swiss Re reporting an annual loss of 7 percent over the past 30 years.

TOP 10 COSTLIEST SEVERE CONVECTIVE STORM EVENTS: INSURED LOSS (1900–2023)

In 2023, 23 of the costliest SCS events took place in the United States and five occurred in Europe. APAC countries also experienced over two dozen SCSs in 2023, though the financial impact of each event was less severe. (Aon, 2024 Climate and Catastrophe Insight)

DATE	EVENT	LOCATION	INSURED LOSS (NOMINAL US$B)	INSURED LOSS (2023 US$B)
August 2020	Midwest Derecho	United States	9.2	10.9
April 2011	2011 Super Outbreak	United States	7.6	10.3
May 2011	Joplin Tornado/SCS	United States	7.0	9.5
May 2003	United States SCS	United States	3.3	5.5
July 2013	Storm Andreas	Europe	3.8	5.0
March 2023	**United States SCS**	**United States**	**4.9**	**5.0**
March–April 2023	**Tornado Outbreak**	**United States, Canada**	**4.3**	**4.4**
May 2019	United States SCS	United States	3.7	4.4
June 2023	**United States SCS**	**United States**	**4.3**	**4.3**
April 2016	San Antonio Hailstorm	United States	3.2	4.1

Hail, in particular, has posed significant concerns in both the United States and Europe. In the United States, the insurance response has been the introduction of wind/hail deductibles. These deductibles will require property owners to retain more risk and thus the financial burden of damage from convective storms. "Insureds should expect to see wind/hail deductibles becoming more prevalent . . . and insurance companies will be evaluating the concentration of their property values within certain [hail-prone] areas."[39]

Europe saw an increase in hail frequency, affecting the insurance industry's approach to covering solar panel damages. According to the European Severe Storms Laboratory, the number of large hail storms was the highest ever recorded in the database, making 2023 the third record-breaking hail season in a row.[40]

Moody's estimates that since 2000, severe convective storms caused approximately one-third of natural catastrophe losses in Australia, with hail a leading cause. A single hail event can and has caused over AU$1 billion (US$690 million) in insured losses.

The global impact of SCSs emphasizes the urgent need for adaptation and innovation within the insurance sector to manage the evolving challenges posed by climate change and extreme weather events effectively.

The need to account for secondary perils such as SCSs is equally front of mind for the real estate industry. As one investment manager noted, "We were affected by the Texas freeze, we've had some really big hailstorm claims, there's a new reality in what you're having to pay attention to, it's not just the CATs [catastrophic events]."

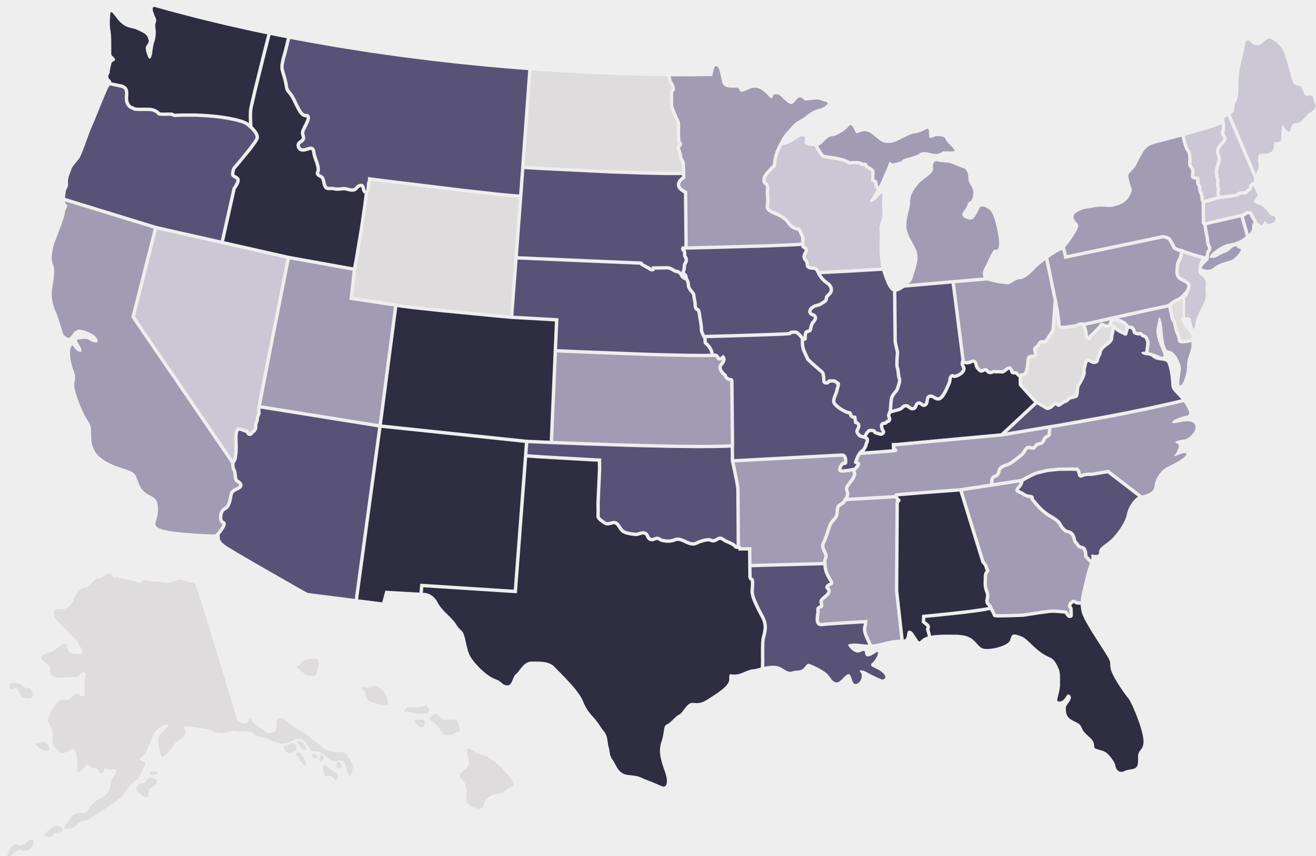
"THERE'S A NEW REALITY IN WHAT YOU'RE HAVING TO PAY ATTENTION TO, IT'S NOT JUST THE CATS [CATASTROPHIC EVENTS]."

Insurance-Driven Migration

Anecdotal evidence suggests that the cost and availability of insurance is among the factors affecting locational decisions made by homeowners in the United States. In California, Florida, Texas, and Louisiana, states that face multiple climate-related challenges, the insurance market is signaling risk through premium increases and limited insurance availability (see Average Home Insurance Premium Increase by State graphic). Historically, these warnings have been ignored. However, a shift may be on the horizon.

AVERAGE HOME INSURANCE PREMIUM INCREASE BY STATE, 2021-2023

(Policygenius, "Home Insurance Prices up 21% as Homeowners Are Left to Deal with Climate Change, Turbulent Market")



- Over 40%
- 30–40%
- 20–30%
- Under 20%
- Insufficient data

States with the highest increases

1. Florida: 68%
2. New Mexico: 47%
3. Colorado: 46%
4. Idaho: 46%
5. Texas: 46%

States with the lowest increases

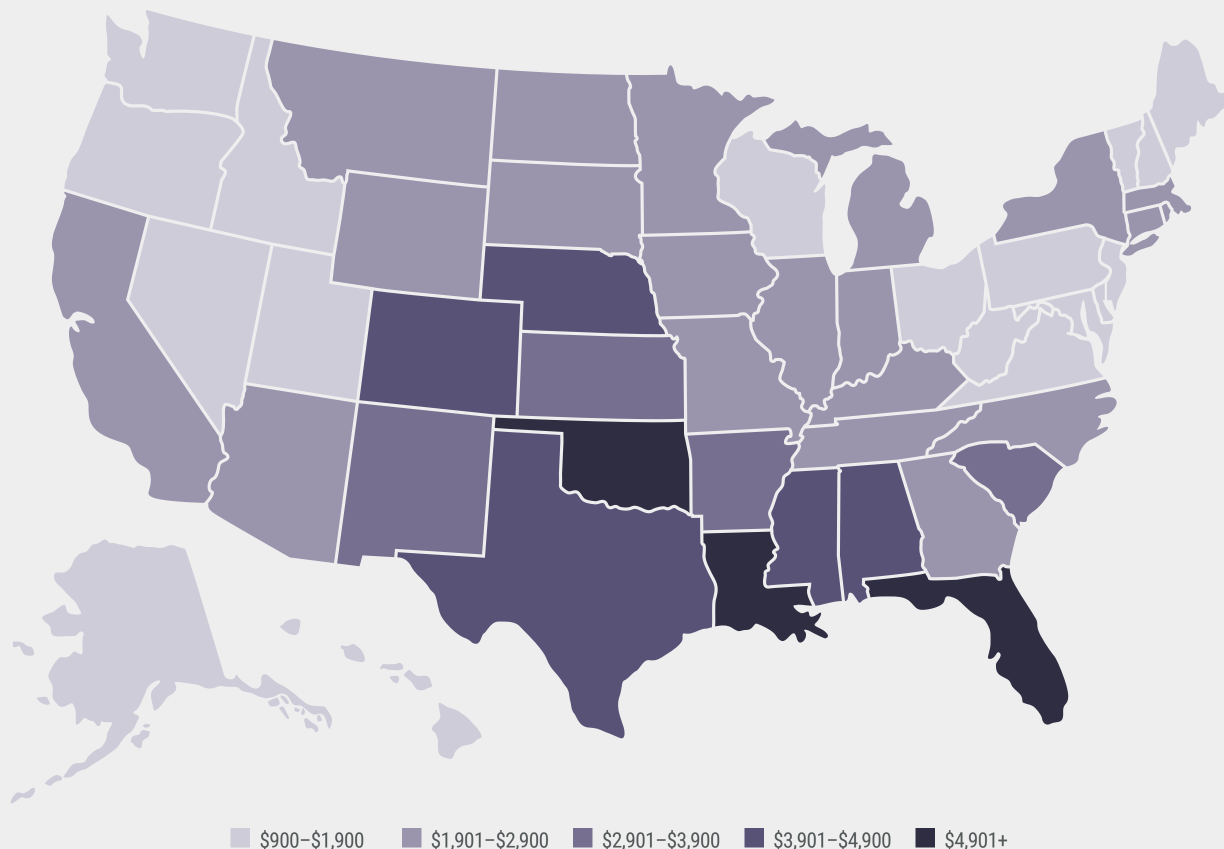
1. Vermont: 7%
2. Wisconsin: 14%
3. Massachusetts: 15%
4. Nevada: 16%
5. New Hampshire: 16%

While Americans continue to move to areas exposed to climate-related risks—Texas and Florida saw the largest population gains in 2023, according to the U.S. Census—statistics from Pods, the moving and storage company, reveal a shift in migration patterns. More Americans are now moving to Tennessee, the Carolinas, and Georgia in increasing numbers. Pods data show that over 60 percent of the most moved-to cities in 2023 were in these three states, with the Carolinas alone accounting for 30 percent of the top 20 cities with the most move-ins. Annual homeowner insurance rates in these states are significantly lower on average and can be up to 50 percent lower than in states such as Louisiana [see Average U.S. Homeowners Insurance Rates by State (2024) graphic].

While the exact impact of high insurance premiums on homeowner decisions is difficult to parse from other factors such as interest rates, tax rates, and utility costs, investors need to keep a sharp focus on this trend. One investment research analyst boldly stated that "investors are starting to cool on the Sun Belt," noting that large-scale investors are now showing more interest in secondary markets such as Knoxville, Boise, and Salt Lake City, as opposed to focusing solely on the top 10 markets in the United States.

AVERAGE U.S. HOMEOWNERS INSURANCE RATES BY STATE, 2024

(Insurify, "Report: Home Insurance Rates to Rise 6% in 2024 after 20% Increase in Last Two Years")



CLIMATE MIGRATION AND REAL ESTATE INVESTMENT DECISION-MAKING

Climate migration-related risks pose serious challenges to real estate investment and society more broadly. The third report of the ULI–Heitman Climate Risk series identifies concepts and strategies for addressing climate migration in the context of real estate investment decision-making.

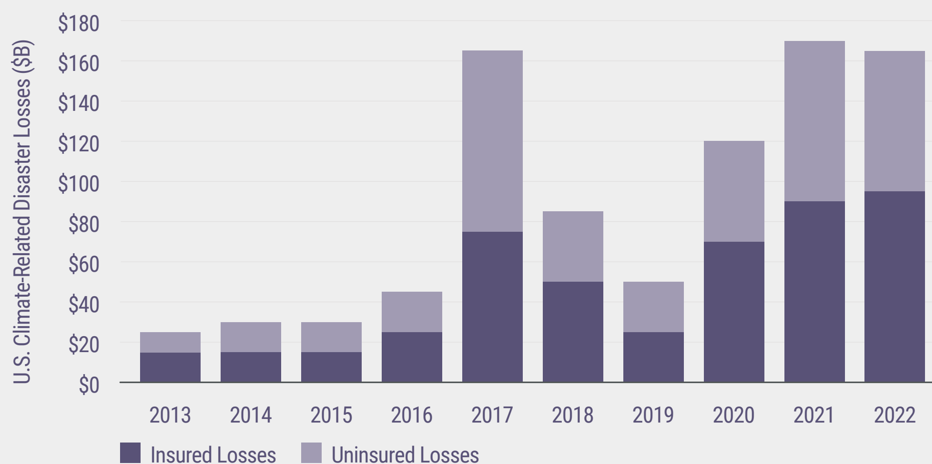
Homeowners Insurance Market Troubles and the Impact on Market Viability

In the first six months of 2024, U.S. single-family homeowners were faced with a 17.4 percent premium increase, compared with 11.6 percent premium increase in 2023. A homeowner who purchased a policy in 2021 underwent a 69 percent increase from 2021 to 2024.[41] U.S. homeowners grappling with securing private property insurance often rely on state-subsidized insurance programs that provide minimal coverage (discussed further in the next section). And a noticeable portion of homeowners—an average of 12 percent nationally and likely between 15 to 20 percent in Florida[42]—who outright own their homes choose to forego coverage entirely.

In the United States, this increase in underinsurance has resulted in growing losses for both policyholders and insurers (see U.S. Climate-Related Disaster Losses 2013–2022 graph). Underinsured policyholders do not have enough coverage to rebuild after a catastrophic event and insurance carriers, due to high levels of underinsurance nationwide, are not receiving enough income to cover the loss costs they incur.

U.S. CLIMATE-RELATED DISASTER LOSSES 2013–2022

Underinsurance for natural catastrophe events in the United States has increased over time and the resulting economic and insured losses have grown on average by about 5 percent annually since 1999. (Insurance Information Institute)



THE INSURANCE PROTECTION GAP

The concept of a protection or coverage gap highlights the difference between total economic losses from disasters and the portion covered by insurance. According to Aon's *2023 Weather, Climate, and Catastrophe Report*, natural disasters resulted in global economic losses of US$313 billion in 2022, with only US$132 billion insured, leaving a 58 percent insurance protection gap.

While less than 1 percent of global economic activity, the insurance protection gap could pose a significant threat to local economies; particularly in areas where the gap is more pronounced.

Similar concerns exist in Europe. The European Central Bank notes that as of April 2023, only one-quarter of the European Union's climate-related catastrophe losses are insured, with expectations that the insurance protection gap will widen due to climate change. A widening gap poses financial stability risks and affects credit provision, especially in areas with a high exposure to flood risk, estimated at about €370 billion (US$414 billion) in exposed physical risk.[43]

In the United Kingdom, the rising cost of home insurance is exacerbating the cost-of-living pressures on households. According to the Association of British Insurers, a succession of severe storms in 2023 left U.K. home insurers on the hook for £573 million (US$767 million) in weather damage, the highest since the data began to be tracked seven years ago. Consequently, there has been a 19 percent annual surge in the average home insurance premium in 2024 compared to 2023. The matter has proved to be of significant concern, with insurance industry executives called to appear before the House of Commons Treasury select committee in April 2024 to face questions over what they are doing to ensure coverage remains affordable.[44]

Australia is grappling with an insurance affordability crisis after facing a string of catastrophic events including bushfires, droughts, cyclones, hail, and flooding. Since the Black Summer bushfires of 2019–2020, there have been 13 declared "insurance events" (catastrophes), with insured losses nearing AU$16 billion (US$11B). This surge in natural disasters has precipitated a dramatic rise in insurance premiums, further exacerbated by state taxes that add 10–40 percent to the cost of premiums.[45] The aftermath is a striking increase in insurance rates, with the median home insurance premium rising 28 percent to AU$1,894 (US$1,240), with even greater increases, 50 percent, for properties in high-risk areas.

Consequently, over 1 million Australian households are now struggling with insurance affordability, as many choose to underinsure or forego insurance altogether. Almost 6 percent of Australians lack home insurance, and a significant majority—over 80 percent of homeowners and renters—are underinsured for their homes and contents, suggesting a wide insurance protection gap.

These un- and underinsured homes pose a significant threat to local economics. As climate change brings increasingly severe weather and the associated damage to these towns and cities, recovery will become problematic. Single-family homes make up almost 90 percent of the structures[46] in the United States and tend to be highly vulnerable. If a majority of these structures fail in any one area, it can lead to a domino effect. With the erosion of the tax base, damaged infrastructure may not be repaired, schools may close, and wealthier residents may relocate. This leads to lower demand for area housing, resulting in reduced rents, with the potential to cascade into reduced demand for other asset types.[47]

The Viability and Market Implications of State Insurers of Last Resort

Of further concern to the economic well-being of local and state economies in the United States is the growing prevalence of government-backed insurance programs. In scenarios where the private sector is hesitant or unable to offer insurance coverage, government agencies have intervened to provide insurance programs. Among the better-known of these is the National Flood Insurance Program (NFIP) in the United States. State-mandated plans are a solution aimed at individuals and businesses unable to secure insurance through the conventional market due to their high-risk nature.

In Florida, over 1 million residents rely on the state-run Florida Citizens Property Insurance Corporation. California's FAIR Plan witnessed explosive growth from 126,709 policies in 2018 to over 350,000 by 2024; at times, they received 1,000 policy applications per day.[48]

Louisiana's Citizens plan has also seen a significant increase in policyholders due to the failure of private insurers. Colorado's decision to create a state-backed insurance plan—which will activate in 2025—serves as a response to insurance companies withdrawing coverage, especially after natural disasters like the Marshall Fire in Boulder County.[49] The growing reliance on government-assisted insurance plans introduces greater financial risk for private insurers.

Last-resort plans are financially supported by all private insurers licensed in a state, sharing profits, losses, and expenses proportionate to their market share in the state.[50] This system places a significant burden on private insurers, particularly as the number of high-risk properties grows, increasing their share of the risk of substantial losses.

Industry experts say the nationwide surge in state-backed policies across the United States is troubling. Concern is mounting that if government-backed insurance programs fail, taxpayers could be asked to fund billions of dollars in bailouts. If such state-backed plans exhaust their reserves, states are empowered to impose emergency assessments on policyholders—both those that hold a private policy and those that take part in the government-backed plan. After Hurricanes Katrina and Rita in 2005, the state of Louisiana levied an emergency assessment on private insurers and policyholders totaling over US$223 million in 2006 dollars (approximately US$348 million in 2024 dollars) to cover insurance shortfalls.[51] In Texas, up to a total of US$250 million per catastrophe per year can be levied.[52] The state of Florida can levy an emergency assessment of up to 10 percent per year for as many years as necessary until the deficit is eliminated.[53] It's important to note that of the 36 state-backed insurance programs in the United States that offer coverage for natural catastrophes, 21 do not explicitly detail how they would pay deficits.[54]

OF THE 36 STATE-BACKED INSURANCE PROGRAMS IN THE UNITED STATES THAT OFFER COVERAGE FOR NATURAL CATASTROPHES, 21 DO NOT EXPLICITLY DETAIL HOW THEY WOULD PAY DEFICITS.

These types of plans are not yet prevalent in European and APAC countries, though Spain does have an Insurance Compensation Consortium that covers losses arising from extraordinary risks, such as natural catastrophes, by charging an extra premium on any private insurance contract. The Consortium differs from U.S. plans as it only covers claims that are excluded by the private insurer, such as an earthquake or a flood, and the insured must already have private insurance in place to benefit from the program.[55]

Emerging Risks for Lenders: Defaults and Devaluations

Banks generally assume climate risk is integrated into property valuations through insurance coverage, implying that market dynamics should naturally address such risks through price adjustments. This

indicates an awareness of the risk but a reliance on market forces for its management. However, this perspective may not fully account for the immediate and tangible threats that climate change poses to real estate values, particularly in regions prone to environmental disasters.

The intersection of climate risk and the banking sector is complicated by the insurance industry's reaction to increasing climate volatility. Banks depend on insurance as a mitigating factor for loans, but in regions where obtaining insurance becomes difficult, the very foundation of issuing mortgages is challenged.

This scenario not only affects the potential for new loans but also poses a risk to banks' existing loan portfolios, especially in concentrated geographic areas. The forced placement of insurance by banks might temporarily shield them, but it does not negate the potential for property value depreciation driven by climate change and, by extension, increased default risk for banks.

Interviews revealed a common optimism among lenders regarding adherence to building codes and proper construction as safeguards against climate-induced damage. This trust, however, might be misplaced or insufficient given the increasing severity and frequency of extreme weather events that outpace updates to building codes. Codes are also designed to provide a life safety level of performance and do not ensure that a building will be financially feasible to repair after a catastrophe. Insufficient insurance coverage represents an economic risk to lenders, particularly for small and regional financial institutions with concentrated holdings in the impacted area.

Higher Cost of Capital: Lenders Transferring Risk to Insurers

While many lending institutions have not yet acted on the rising risk climate change poses to their financial viability, some larger, leading institutions are starting to act. As leading banks begin to operationalize a physical climate risk management strategy, investing in high-hazard areas could bring additional financial consequences beyond rising insurance costs. A major insurance broker revealed, "If you're servicing or financing an asset through debt, we're starting to see some banks increase the terms on their debt because of risk. Specifically, a percentage increase in the cost of debt simply because it's in a higher, more [CAT] exposed area." He went on to share that the large institutional banks he works with are starting to assess climate risk. At the time of loan orientation, he explained, the bank will factor in climate and "they'll have some credit-based views on how that impacts your ability to repay" the loan. This trend, while not universal, is mostly observed in the United States and parts of Europe, with expectations that it could be happening in developed markets of Asia as well.

Conclusion

Rising insurance costs stem from a variety of pressures—including inflation, the cost of reinsurance, regulatory restrictions, and the higher frequency and intensity of weather-related claims. As disasters continue to increase in frequency, intensity, and cost, it's likely that insurance affordability will continue to pose a challenge for the real estate sector.

Investors—particularly those with large commercial real estate portfolios—and their teams of insurance brokers and third-party consultants have found creative ways to lessen the cost burden of insurance. These often-complex strategies may include tactics such as high deductible policies, opting for self-insurance solutions, and/or the use of excess and surplus lines.

While property insurance prices are increasing for CRE, coverage remains available and thus investors have not significantly altered the markets in which they choose to invest. The rising costs of insurance has, however, led investors to more deeply consider physical climate risk exposure, asset and construction type, the need for risk reduction strategies, and the geographic diversity of their portfolio.

Looking ahead, leading investors are keenly aware of how the rising costs of insurance premiums and lack of insurance availability is already impacting single-family homeowners. They're mindful of the possibility of insurance-driven migration, the growing insurance protection gap, and the solvency of government-backed insurance programs, and they are monitoring how these cascading effects could affect the viability of markets highly exposed to physical climate risk.

Glossary

Admitted insurance carrier: insurance providers who are licensed to operate by the state insurance agency in which they're based (These agencies govern nearly all aspects of an admitted insurance company's operations, including capitalization requirements, policy forms, rate approvals, and claims handling. Contrarily, nonadmitted insurance companies are not subject to these regulations.)

Aggregate deductible: a single deductible applied to all claims within a policy period rather than traditional per-occurrence deductibles

Buffer layer: insurance coverage that fills the gap between a primary insurance policy and excess protection

Captive insurance: when a business owner sets up an insurance company to insure its own risks

CAT: catastrophe, a severe loss characterized by extreme force and/or sizable financial loss

COPE: Construction, Occupancy, Protection, and Exposure; how insurers assess risk

Deductible: the amount of money an insured party pays before their insurance policy starts to cover loss expenses [Deductibles can vary depending on the type of insurance policy, the level of coverage, and other factors. They can be fixed amounts or a percentage of the total insured value of the property. Percent deductibles are common for certain types of loss events, such as earthquakes and named storms (tropical storm or hurricane/typhoon). More recently, hailstorm percent deductibles have become common and water loss (leakage/burst pipes) are being considered. Deductibles apply to all types of property insurance policies, whether a primary policy, excess policy, E&S policy, or other type of hazard-specific policy.]

Deductible buy-down policy: an insurance policy that covers deductible costs; may cover "all risk" perils or specific named perils such as windstorm and earthquake

Discount: an immediate reduction in premium costs for policyholders who meet certain criteria

Excess insurance policy: a policy that covers a claim after the primary insurance policy limit has been exhausted

Excess and surplus (E&S) lines carriers: carriers that provide coverage for high-risk exposures traditional insurance carriers are not willing to cover

Force-placed insurance: an insurance policy placed by a lender, bank, or loan servicer when the property owner's own insurance is canceled, has lapsed, or is deemed insufficient and the borrower does not secure a replacement policy. This insurance allows the lender to protect its financial interest in the property.

Hard insurance market: a market characterized by rising premium rates and less available coverage

Hazard-based risk assessments: assessments that allow insurers and reinsurers, financial institutions, corporations, and public agencies to evaluate and manage natural and manmade catastrophe risk from perils ranging from earthquakes and hurricanes to floods and wildfires; tools to assess risk include catastrophe modeling and predictive modeling

Insurance broker: an insurance intermediary who represents the insured rather than the insurer

Insurance carrier: a company that creates and manages insurance policies and is typically the financial resource behind them (also known as primary carrier)

Insurance protection gap: the coverage gap between total economic losses from disasters and the portion covered by insurance

Insurance tower: a collection of excess-of-loss insurance policies that work together to protect policyholders from catastrophic losses or liabilities

Layers/layered coverage: defined in terms of amount of insurance, layers can be serial or parallel and multiple insurance carriers can take part in a single layer; each insurance carrier or group of insurance carriers are only responsible for paying out losses within their layer

Margin clause: a clause that limits how much a property may increase in insurable value during the policy period (typically one year) from what was originally declared in the statement of value (SOV)

Parametric insurance: a policy that pays out based on the occurrence of predefined trigger events, rather than the losses incurred

Premium: the amount of money the insured pays the insurer to purchase insurance

Premium credit: a reduction that lowers the premiums paid

Premium leakage: the loss of revenue due to policyholders not paying their full insurance premiums

Primary carrier: See insurance carrier above.

Primary insurance policy: the first policy to pay out in the event of a claim even if there are other insurance policies within the insurance tower

Quota share: a method of insurance coverage where multiple insurance carriers share the risk of a specific risk by sharing the risk's loss limit; in a quota share, each insurer takes on a percentage of the loss and premium

Reinsurance: insurance for insurance companies; a type of insurance that is purchased by insurance companies to reduce risk

Self-insurance: when a business owner assumes all financial responsibility for potential losses (partially or in total)

Self-insured retention (SIR): a type of self-insurance that allows for direct payment of losses up to a certain limit before insurance coverage is activated without reducing policy limits

Severe convective storm (SCS): a thunderstorm characterized by heavy rain, intense winds, tornadoes, and hail

Social inflation: a term used to describe social and behavioral trends that can increase insurance claim costs above economic inflation; generally thought to be due to a trend in increasing litigation costs

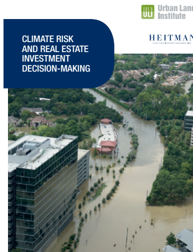
Soft insurance market: when premium rates tend to be stable or decrease due to high competition among insurers, and insurance products are more accessible

Statement of value (SOV): a report the insured submits to an insurer detailing how much a property is worth so the insurance premium can be calculated; outlines the property insured, its type (e.g., building, equipment, or stock), the value of each piece of property, and the method used to calculate that value

Syndicate: a group of companies or underwriters who join together to insure very high-valued property or high-hazard liability exposures[56]

Total insured value (TIV): the value of property, inventory, and equipment covered in an insurance policy; the maximum dollar amount that an insurance company will pay out if an asset that it has insured is deemed a constructive or actual total loss

The ULI–Heitman Climate Risk Series



2019: Climate Risk and Real Estate Investment Decision-Making
This agenda-setting report introduces the key links between climate risk and real estate investment and focuses on how real estate investors incorporate asset-level climate risks in their investment decision-making processes.
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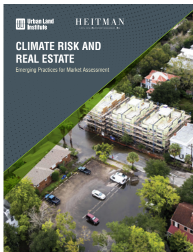

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2024: Insurance on the Rise: Climate Risk and Real Estate Investment Decisions
This report outlines the critical intersection of property insurance, physical climate risk, and real estate investment decisions across the globe, offering strategies for managing rising insurance costs and physical climate risk in assets and portfolios.

Contributing Partners

This report was informed by interviews with a wide range of commercial real estate executives, insurance brokers, insurance carriers, reinsurers, and lenders; including but not limited to the following:

AMLI

AON

AXA

Dominium

Edge Environment

Hines

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Killian Pacific

LaSalle

Link REIT

Lockton

MBA

Munich RE

NEO

Sentinel Real Estate Corp

Tanner, Ballew and Maloof

Willis Towers Watson

Yardi Systems

Notes

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