AmWINS Group, Inc.

STATE OF THE PROPERTY MARKET

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PROPERTY UPDATE - Q2 2018

Abundant capacity characterizes current property market, with few exceptions; CAT pricing continues to be up marginally entering 2018 hurricane season.

As we enter the second half of 2018, it's clear that predictions of significant rate increases made in late 2017 have not materialized. Underwriting companies hoping to see a meaningful hardening of the overall property market have been disappointed. Renewal rates have been flat to up marginally on non-catastrophe exposed property. Insurers that anticipated hardening and pushed for rate increases early saw themselves losing business.

Nevertheless, there are pockets of exceptions. Catastrophe-exposed and frame habitational, woodworking-related businesses, dealer open-lot, cat-exposed hospitality and accounts with consistently poor loss experience can expect a tighter market. A good portion of this tightening is a result of carriers' realization that loss expectancy is much higher than prior expectations for the class. Larger national placements with multiple carrier participants are often faced with limited options, as most new capacity has not entered this space and we've seen a retraction or reevaluation by most carriers.

Cat-exposed properties are seeing mid to high single-digit increases. Accounts that also have adverse loss history or that have lost capacity from incumbents seeking to increase rates or to decrease their cat aggregates can expect more. Yet even among these more challenging sectors, brokers can find better deals for clients by providing quality submissions to underwriters.

"The better, more detailed exposure data we can provide to carriers, the better we can negotiate terms," says Harry Tucker, national property practice leader at AmWINS. "Brokers used to think that it was better to provide less information about a risk. Now, with modeling playing such a large role and defaulting to worse case when information is left out, we have found it best to be as granular as possible to obtain optimal results." Advanced modeling is leading to greater underwriting sophistication and pricing precision, moving the industry toward a much more level and stable market and minimizing the need for drastic corrections.

The key driver behind the continued competitive property market is capacity. "In spite of the historic catastrophe season of 2017, the market has remained stable. Alternative capital continues to enter the market at an increasing pace," Tucker says.

Alternative capital was up 17 percent in 2017 – from $75B to $88B, according to WTW – and accounted for 12 percent of total industry surplus. Furthermore, industry surplus reached an all-time high of $719.4B, up $18.6B from $700.8B at the end of 2017.

BUILDER'S RISK

As we close out the second quarter of 2018, brokers can expect more of the same competitive market conditions in builder's risk. Capital continues to enter this space seeking accounts with best-in-class risk characteristics. As a result, aggressive rates on desirable classes remain at or below historic lows.

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Frank Catalano, executive vice president and builder's risk specialist at AmWINS Brokerage of the Midwest in Chicago, is confident that the pace of construction can be sustained.

"Large developers continue to have robust pipelines of projects, both commercial and residential," Catalano says.

As is traditionally the case, most of the E&S growth opportunity is in more challenging frame and coastal construction. Although the industry has seen approximately $500M in frame losses over the last 24 months from severe fires, there is a market and capacity for the class, albeit at higher rates and more restrictive terms/conditions.

Rates are up roughly 15 percent compared to the first quarter of 2017, within the E&S sector of the builders risk market. Carriers are pushing actuarial data in a broad stroke approach for this class of business. This approach is unfavorable for best-in-class developers, as underwriters are using benchmark pricing for the class instead of underwriting the merits of each client or project individually.

Despite the challenges of insuring frame construction, intense competition from standard markets is driving rates as low as 4 cents on concrete construction. Brokers may also find standard markets pursuing some stick-built risks in an effort to grow premium.

Critical CAT pricing is stable and we expect it to remain consistent going into the 2018 wind season. In catastrophe-prone coastal regions, standard markets are competing to write quality, wind-resistant construction projects, presenting only limited opportunities for E&S markets. However, when standard markets come up short in named windstorm, flood, and earthquake limits, the E&S market place is able to play a role.

Renovation activity has also increased. Renovation pricing varies widely based on the scope of work (cosmetic versus structural) and exposure to catastrophe risk. Detailed engineering and geological reports are compulsory to obtain the best possible terms.

EARTHQUAKE

Earthquake capacity continues to grow and is now at an all-time high. Moreover, we believe, between $750M and $1B is available through wholesale distribution; more is available in the global marketplace (mostly linked and supported by the all-risk placement). Abundant capacity exists despite media reports of the massive exposure that exists and compelling new studies detailing the extent of U.S. earthquake risk. In fact, the U.S. Geological Survey recently referred to the East Bay fault as a "tectonic time bomb" more dangerous than San Andreas.

"Because there hasn't been a major earthquake in California since Northridge in 1994, carriers overall are being aggressive, despite the inherent risk," Tucker says. Large accounts are seeing flat to 5 percent reductions, with only thinly-priced, old, or substantially exposed properties seeing 5 to 10 percent increases. On newer buildings and large schedules, one percent deductibles are also achievable.

As always, there are exceptions. Updates in RMS 17 and a new version of AIR have doubled the probable maximum loss (PML) on some exposures, including areas along the Hayward fault (South San Francisco Bay Area, towns of Hayward, Union City, Fremont and regions around San Jose). The resulting micro-hard market in those areas has pushed premiums up anywhere from 10 to 50 percent.

Despite the record-high capacity already in earthquake, new capital is constantly looking to participate in the market. In this environment, brokers do well to partner with a wholesaler that has broad market access, specialized knowledge, and strong underwriting relationships to obtain the best deal.

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LOOKING FORWARD

- Expect the overall current conditions in property to continue
  - Increased alternative risk traditional carrier appetite, combined with increased traditional carrier surplus, will produce a stable market
  - Increased upward rate pressure on poor performing accounts and classes
- Greater dependence on modeling due to increased value of complete and accurate account data
- In builder's risk, a strong economy will continue to fuel growth in building projects
  - If federal infrastructure spending becomes reality, construction will see an additional uptick
  - Standard markets will compete aggressively on desirable infrastructure projects, including utility construction, energy facilities, and associated buildings
- Unless and until there is significant loss activity, additional capacity will continue to flow in to earthquake, keeping overall conditions soft