Why Inflation is Impacting Property Insurance

We are all aware of how inflation is impacting everything we buy today. The commercial construction business is no different as we are seeing the cost per square foot rising significantly the last few years. For example, in 2009-10, new school building construction went for about $160 per square foot, today, most projects are over $300 per square foot. The construction cost inflation is now directly impacting the insurance premiums for public school clients. Commercial insurance rates have already been on the rise due to inflation, increased building costs and supply chain issues and is impacting all industries.

How do rising property costs affect insurance?

The answer is there is a direct link between the value of a commercial structure and the cost of insuring it with a comprehensive policy that provides replacement cost coverage.

Hurricane Ian, hit Florida on September 28 last year, has gone down as one of the most destructive storms in U.S. history. High winds, storm surges and expansive flooding have caused billions in residential and commercial real estate damages. With rising interest rates and labor and material shortages, recovery of the devastation will likely be both slow moving and expensive. In addition, storm damage claims in the Midwest are impacting the reinsurance markets that directly impacts the insurance companies you work with.

Construction costs and real estate values have increased virtually in tandem since the start of the COVID-19 pandemic in March of 2020. As the pandemic eased in the middle of 2022 rapidly rising property values continued to dominate the real estate market, as well as the cost associated with building supplies.

Ian’s cost of wind damage on residential and commercial properties is estimated to be some $22 billion to $32 billion, while the storm surges have destroyed another $6 billion to $15 billion in real estate assets, according to a report by Core Logic, a company that many property insurers use for their property valuations.

Fourth-quarter results are not in as of yet, but third-quarter 2022 marked the 20th consecutive quarter of increased premiums for commercial property/casualty, according to the latest report from the Council of Insurance Agents and Brokers (CIAB). The average rate increase across all account sizes was 8.1% in Q3 2022, up from 7.1% in the second quarter. Many of the results are regionalized and can vary greatly from urban to rural areas and by State.

According to a survey of national insurance carriers, commercial property saw premiums rise an average 11.2% in Q3 compared to 8.3% in Q2, driven by inflation and natural catastrophes. The vast majority (95%) of brokers agreed inflation was influencing market trends in the third quarter, especially in commercial property. Inflation increased construction costs, which led to increased property valuations, said CIAB. The three major components of construction process include steel, wood and concrete. All three commodities have increased dramatically in cost the last three years.

More than half of respondents reported an increase in commercial property claims in Q3, possibly driven by catastrophes. Flood were up in Q3, with 31% of respondents reporting an increase. One respondent said catastrophe-property "saw significant rate increases and restriction of capacity," which another reported big increases in deductibles.

What Can You Do?

First, have a discussion with your broker on what specifically will be happening with your school's valuation this year. Be cautious if they tell you everything is flat. That is highly unlikely in the property market.

Second, discuss options for your school. A key term in property risk management is "spread of risk." Does your school have spread of risk, which means you have multiple buildings spread out over a large area. Then you can look at options of being 80, 90 or 100% insured to value. Public schools that are in one k-12 building, do not have this option and need to insure at 100% to value, because you could lose your building in a severe loss.

Third, look at your statement of values for each of your buildings and calculate the cost per square foot. Ask what valuation service your carrier is using and when was the last time the values were updated? It should be every year. In addition, review your business personal property and property in the open limits. Bleachers, lighting, fencing, dugouts and other outdoor structures have gone up in cost as well.

Lastly, when working with new commercial producers, I tell them on commercial property, insure the property on a replacement cost basis, blanket the coverage on all the buildings and add the Agreed Value endorsement. By having those three items on a policy, will cover the vast majority of incidents that can happen to a building.

Expect some changes in your property values this year and look at options to keep your premium costs down. Please contact me if you have questions or want to look at options. **Read on to see the two resources from CBiz that help to explain what construction inflation had done and why it is going up so much.**

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Mitigating Inflation's Impact on the
Commercial Insurance Market I Property & Casualty

Key Causes of Inflation

Labor Shortages
The past year has seen labor shortages in nearly all sectors. In fact, a recent study from the Society for Human Resource Management (SHRM) found that almost 90% of businesses are experiencing struggles in filling open positions. These widespread labor shortages are attributed to various influences.

Primarily, the impact of the pandemic has triggered many workers to reevaluate their employment priorities and deterred unemployed individuals from returning to the workforce. Staggeringly, the proportion of individuals who have been out of work for six months or longer is at its highest in 60 years.

These labor shortages have led to substantial struggles for businesses and caused operational delays. Some employers have even been forced to increase their compensation packages to retain or attract workers. Such trends have magnified overall labor costs and led to subsequent concerns. Some experts estimate nearly 85 million jobs could remain unfilled and project a trillion dollar loss of economic opportunity.

Supply Chain Disruptions
Supply chain disruptions have stemmed from increased demand for various items and materials amid production slowdowns during pandemic-related closures. Even as businesses have resumed normal operations and increased production levels, consumer demand has continued to outpace inventory. Contributing to inflation issues, the costs of many items and materials have soared to counterbalance demand.

Looking ahead, experts anticipate supply chain conditions to improve in the latter half of 2022, lowering the risk of disruptions and helping ease inflation concerns. Yet, a combination of continued labor struggles, the Russia-Ukraine war and other lasting pandemic impacts are expected to keep the inflation rate above pre-pandemic levels through at least 2023.

Brought on by pandemic-related labor and supply issues, inflation has become a growing concern and is clearly reflected in the rising Consumer Price Index (CPI). In fact, the latest Bureau of Labor Statistics (BLS) data reported the CPI for all urban consumers surged by 7% in 2021. This represents the largest increase over a 12-month period since 1982. Currently the CPI is averaging a historical 0.6% monthly increase.

These inflation challenges could create a number of difficulties for commercial insurance policyholders and inusrers.

(cont'd)

The Commercial Insurance Market's Impact

Historically, prolonged inflation during the 1970s and 1980s caused reduced reserve levels, unpredictable claims trends and weaker underwriting performance. Insurers saw major losses and policyholders had multiple coverage challenges. The current insurance industry is better positioned to sustain reserve losses due to outsized investment gains. Furthermore, financial reporting advancements have provided insurers with additional capabilities to identify and respond to loss trends. The current inflation uncertainty could eventually threaten the long-term stability of the insurance industry's reserve levels and underwriting profitability.

Commercial Property

Property insurance has suffered from a combination of inflated repair and rebuild costs, as well as construction workers shortages. Supply chain issues related to essential building materials has influenced prices to skyrocket. The National Association of Home Builders reports the costs of lumber and steel have more than doubled. Such inflation is further evidenced by the latest BLS data that shows a substantial CPI increase for a number of structural elements (e.g., floor coverings, window coverings, major appliances, overall construction materials).

Insurers are experiencing some poor underwriting results from elevated property loss costs. You should prepare for a potential increase in premium expenses and other coverage restrictions. Be sure to reevaluate your polices for underinsurance concerns.

Commercial Auto

The commercial auto market has been heavily affected by surging repairs and claims, worker shortages and supply chain disruptions. According to the BLS, these concerns are reflected in an increased CPI for auto parts, motor vehicle repairs, and used cars and trucks. Skyrocketing accident frequency and severity have evolved from rising crash rates and inflated medical treatment expenses. These conditions could eventually influence underwriting losses and impact policyholders with heightened premium expenses and coverage restrictions.

Steps to Mitigate Complications

Inflation has the potential to heighten your premium costs, influence coverage restrictions and promote underinsurance concerns. You can minimize these complications by implementing the following steps:

1. Start Early

Schedule in advance with your trusted insurance broker to strategize for the upcoming renewal process. They can help you understand current inflation trends and how they affect your policy. Starting early will also provide you time to prepare for potential policy changes. While inflation remains volatile, you may also want to schedule quarterly broker meetings to adjust coverages to current market conditions.

2. Review Coverage Terms & Conditions

Your broker should assist with reviewing your current coverage terms and conditions, especially any exclusions. Verify your policy limits and potential sub limits are adequate to cover a loss. Should any underinsurance issues be identified, you can ensure proper protection by updating coverages and purchasing policy endorsements.

3. Reassess Property Valuations

Verify your commercial property insurance coverage reflects correct property valuations. Confirm your current policy will cover recovery expenses after a loss in light of current property repair and rebuilding cost inflations. Outdated valuations could leave you underinsured if expenses exceed your existing coverage limits.

4. Ensure Adequate Risk Management Practices

Risk management measures can save your organization from unnecessary exposures. Your risk advisor can verify you have effective risk management measures in place to prevent potential claims. Your broker can also help you qualify for premium discounts or prevent increases with risk mitigation documentation for underwriters.

We're Here to Help

As the economy continues to suffer from historic inflation, you're not in this alone. We're here to help you not only understand how inflation affects your insurance but also suggest risk management strategies to lessen your policy's impact.

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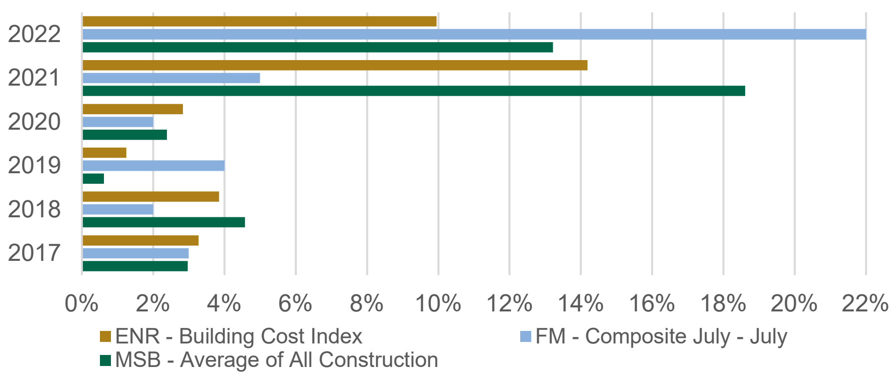
COST TREND UPDATE
October 2022

CONSTRUCTION COST TRENDS

Inflation is not the only challenge impacting construction costs. While certain material costs increases may have subsided and some supply chain issues have diminished, the construction industry is faced with significant labor challenges. The shortage of skilled labor, coupled with increasing wages, is extending project completion timelines and impacting the cost of both existing projects and new bids.

Construction Cost Trends October Yearly



2022 Construction Cost Trends

10.0% ENR: Building Cost Index

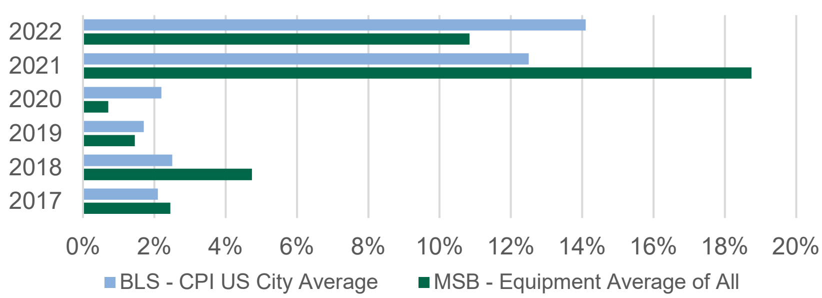
22.0% FM: Composite July - July

13.2% MSB: Average of all Construction

EQUIPMENT COST TRENDS

Equipment prices have also increased again over inflation, with equipment costs rising an average of 12.5% over the last 12 months.

Equipment Cost Trends October Yearly



2022 Equipment Cost Trends

14.1% BLS: CPI US City Average

10.8% MSB: Equipment Average of All

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Sources
Marshall & Swift/CoreLogic - Quarterly Cost Indexes
FM Global - Cost Trends - Industrial Buildings
US Bureau of Labor Statistics - Consumer Price Index
Engineering News-Record
Risk Management Solutions