

The Property Line: Rethinking Risk: Navigating Today's CRE Insurance Market

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Welcome to The Property Line, a commercial real estate podcast brought to you by Seyfarth Shaw's Real Estate department. The Property Line is a brief discussion of current market trends, bringing you insights from our acclaimed national team of real estate attorneys. Each episode focuses on a key takeaway for the busy real estate professional. Now, on to this week's discussion.

James O'Brien

Hello and welcome back to The Property Line. My name is James O'Brien, and my co host today is Eric Greenberg. We are both partners in Seyfarth Shaw's Real Estate practice, and today's podcast marks a special occasion: it is our 75th episode of The Property Line. We launched the podcast about five years ago in October 2020, and we are still going strong, so thanks to all of you who have found us and enjoy listening. We're joined for this special occasion by Rebecca Woods, a Seyfarth Litigation partner who practices throughout the country, but is based in Atlanta, where she leads that office's Litigation group. Rebecca is also the co chair of our national Commercial Litigation practice, and she has extensive experience handling both real estate and insurance matters. She's joining us to discuss the insurance issues that she is currently seeing in her practice. Welcome, Rebecca.

Rebecca Woods

Hi James. Thank you. Happy to join you.

James O'Brien

Yeah, you're quite welcome. I think you're a repeat guest, and we're glad to have you back. Exciting topic today, at least it's one that I think is top of mind for people. Both the cost and availability of property insurance have been top concerns for real estate investors lately. In fact, 43% of the survey respondents to our Annual Sentiment Survey flagged this is a top concern for 2025 and it seems to be have been borne out that way. Both inflationary pressures and more frequent and severe natural disasters have driven up the cost of property insurance, and in some cases, it's simply not available. So Rebecca, what are you actually seeing as the main drivers for increased cost of property insurance? And how are the companies you're working with dealing with the new reality of high insurance premiums?

Rebecca Woods

Well, first, I want to respond to your characterization of insurance as exciting. I think someone beg to differ, but, but it is important, and it is top of mind because I'm actually seeing it break deals. Deals are no longer penciling out, and they've been having that struggle for about two years now. The causes are myriad. There's no single cause. It's a complex system. One of the issues that people are pointing to is something called social inflation, and that is this perception that the world is spinning out of control, and it is certainly amplified by these mega jury awards that don't seem to be slowing down. Third party litigation funding is actually I mean, these are all like a field of what real estate folks are thinking about. But these are all inputs into the complex system of what insurance companies bake into the pie when they start ratcheting on premiums. And this, this concept of third party litigation funding is when very wealthy entities or investors actually help to fund cases that could yield these kinds of break the bank

jury verdicts. So that is adding fuel to that fire. And as you already mentioned, catastrophic climate events are really problematic. But then you add into that inflation cost of building supplies, and, of course, geopolitical risks. So there isn't a simple solution to address the rise in insurance costs, and they're probably here to stay. In terms of how are companies dealing with that, there are a couple of strategies, other than gripping your seat and cursing and being very frustrated with how the digits are increasing. I looked at it briefly. The cost of insurance has increased. It increased so materially, particularly in property, it increased this year, it's moderated from about to about 3.8% increase, whereas last year was about 6%. But in casualty, some areas are going up 10 to 20% so the costs are through the roof. Okay, so how are companies dealing with that? I think one of the main drivers it seems so inglorious, is strong risk management, and that is an internal process. Risk managers, I think, are more in demand than ever, and it also involves partnering with their insurance companies, large, sophisticated insurance companies have programs, particularly in property risk where you can you can call them in they can do a risk assessment. There are programs you can embrace. It's a little akin to when you buy residential home insurance and the insurer wants to know if you have a wired in security system and you get a discount, you can sometimes work with your property insurer that way. The other way to manage your costs is to simply put in for higher deductibles or a self insured retention which kind of functions as a higher deductible, meaning that you're telling the insurer, I will take the first layer of risk, I will pay. And that tells the insurer two things: one most importantly, which is that you will not be making rinky dink claims. So if you are a tenant or a landlord and you embrace a much higher deductible, let's say it's \$200,000, if you had had a deductible of \$50,000 that insurer knows it's exposed for more claims than if you had a deductible for \$200,000 and that can very materially reduce your premiums. And then the only other kind of key way is to bundle policies, or engage in some sort of pool group, pooled risk program, but bundling policies is probably more realistic for many companies. I think people will resonate with this, because we do it as individuals. You know, if you get your home and your auto all with the same insurer, sometimes you'll get discounts. So I think those are the key strategies to try and manage those costs.

Eric Greenberg

So maybe let's take a dive just in specifically to property insurance. A lot of our clients and one of the landlord or tenant side have to get property insurance, especially since it's going to be required by all lenders. What are some alternatives to standard property coverage?

Rebecca Woods

Well, lenders want property insurance. They want licensed, admitted in carriers to insure. So there's not a lot to be done there. A lot of people have heard of captive insurers, and a good number of companies have that are bigger and well resourced have created their own captive insurers. I am not seeing as a general matter that mortgagees are accepting captive insurance as a replacement for a third party licensed and admitted carriers, so that that's a that's a big problem. Otherwise, Eric, I think you're looking at trying to be creative and negotiate things like retrospective premiums or, yeah, I think those are kind of the key things. But if you have a loan, you are on the hook for getting property insurance. And then the question is, how do you manage the costs?

James O'Brien

And what about the possibility of self insurance? You mentioned self insured retentions, you mentioned captive insurance companies. I gather what you're saying is lenders are not permitting that, but say that is an option. You know, what kind of self insurance products have you seen people using? And then does that just mean I don't have insurance, or is there something more, more to it?

Rebecca Woods

Yeah, so self insurance is probably a casual way of referring to a number of different ways to go about it. The most simple would be what is fundamentally self insured retention and SIR, and that is where you are, in fact, self insured, but only up to a limit. And I think I certainly know that in the casualty realm, for our, you know, for commercial tenants and owners, self insured retentions are becoming more standard, because they're an easy way to manage the costs. So say, for example, I have commercial general liability policy for \$10 million dollars with excess layers on top of that, but that \$10 million primary layer has gotten really expensive. I might opt to have a self insured retention of \$8 million or \$5 million and that means what I've really done is I've turned that primary layer into functionally a secondary and umbrella layer. And if I have a loss within that \$5 or \$8 million, whatever I've decided my SIR is, I'm footing that whole bill. Now for casualty, I can decide what I want to do for casualty. I mean, every once in a while, those casualty limits are required, but on property insurance, I'm not seeing meaningful SIRs on property insurance, but well resourced clients, well resourced businesses can probably negotiate. And I think that's kind of the part of the important part here. Insurers are fundamentally in the business of negotiating with potential insureds for their premiums. You know, they want to take in premiums. They want to invest them. And so if there's a company that has the ability to and has leverage to say, hey, my premiums are worthwhile. Let's engage in a discussion. I'm well resourced. I can show you my balance sheet. I can handle an SAR of, you know, \$5, \$10, \$40 million, whatever it is, in order to work down the cost of this property insurance. I don't see why a lender wouldn't be amenable to that if the lender was otherwise not, not amenable to full self insurance, because at the end of the day, it's really about risk allocation, right? That's what insurance is, and that's what a lender borrower relationship is. So if the lender thinks that the borrower, the lender is shifting to the borrower all of the risk of that loss of that that property, and so if the borrower can show the lender that that shifting of the risk to the borrower is safe, and not just subject to the borrower saying, hey, I'll pay for it. And, you know, fingers crossed behind my back, I may not have the money for it, and lender, you'll be stuck. I think the lenders will be amenable to that kind of discussion.

James O'Brien

I mean, most of the time where I've seen legitimate self insurance provisions in a document where the parties are sophisticated and thinking about it. I mean, it does come with financial tests for the party that's doing the self insurance that make the counterparty comfortable that they can absorb the risk that they're taking on.

Rebecca Woods

That's right, the best way to do self, true self insurance, not just an SIR, is to have a captive insurer. Those are really relegated to the most well resourced businesses because they're very expensive, and then you basically become a true insurer, and so you have to subject yourself to that state's regulatory regime, and it's, it's a whole lot of paperwork, and it only makes it makes financial sense if the company is big enough, and if they think that they can manage their own risks well enough that it's financially worth it, right? So that basically, the amount of premiums that they would be paying to an insurer, they're thinking that the cost of them being their own insurer, complying with all their regulatory hoop, jumping through those hoops and paying out their own claims, has to be less than going out on the open market. Now, I think we're going to see more captive insurance companies, because I think the open market is getting so expensive now that I think, I think in the next couple of decades, we're going to see a pretty meaningful shift in what it means to be an insurer. We'll always have room for big, massive insurers. Lloyds is not going anywhere as kind of the creative insurer and excess insurer of choice for many, and neither are the big insurers. But I think the kind of the medium sized companies for whom having a captive insurer is now not economically viable, those will become more economically viable as these premiums increase.

James O'Brien

Right, I can see that, especially if you as a company, think your risk profile is slightly under that of the general population, if you will, so that they should be able to insure for less now, maybe that gets baked into their insurance products, but perhaps not as you say, as insurance goes up, there's more incentive to find ways to avoid having to have it.

Rebecca Woods

That's right, absolutely.

Eric Greenberg

Rebecca, you touched upon this a little bit in some your comments, but maybe we can explore it a little bit more. Are there ways that owners and occupiers can manage their risk, specifically, how to avoid paying such high premiums?

Rebecca Woods

Well, I think in addition to the issues that we've already talked about in terms of having engaged risk management and doing things like trying to massage your payments, your insurance program at the outset, you know, with SIRs looking at group risks, etc, then you move into the internal operations. And, sorry, that would be the risk management and figuring out how can I do everything I can to avoid hitting on my loss history. So loss history is this magical number that insurers look at when they underwrite, particularly new insureds, but when your time for pre renewal, if you have been making claims, then the insurer bakes that in and now, particularly with the use of AI, which is becoming increasingly controversial everywhere when it's being applied to business and pricing decisions, insurance companies are using AI to try and refine an understanding of the risk profile. Those loss histories used to be important, and now, increasingly, they're going to be absolutely critical. And the name of the game in the business world is have a loss hit someone else's loss history, and not yourself. So one way to do it, Eric, is to try and negotiate contracts with, you know, contracting counterparties somehow, you know, for a landlord and a tenant, that might become a little bit of a hot potato if there's shared risk of who needs to take the first hit, because it's going to hit your loss history, not mine, and so your premiums will increase and not mine. So those are some of the kind of very insurance oriented approaches that can be taken. One instance, one factor that I think particularly tenants, although landlords, it's a double edged it's two sides of one coin. Should consider is what happens in allocation of insurance costs, particularly in triple or double net leases. I had an instance recently where a tenant client of ours saw their insurance share jumped massively. It was beyond out of the ordinary. They were not in Florida. I won't name the state that they were in, but they were not in Florida, which is seeing crazy increases in property insurance premiums. And when we looked at their lease, it had interesting language in it that allowed this tenant to push back on the landlord regarding how the landlord was calculating that tenant's share of insurance.

James O'Brien

Just to step back, you're saying that the scene, the landlord is recovering the insurance expense, so the landlord's insuring the building, or whatever property, and then is passing along those costs to the tenants, And each tenant is paying its share, and you're saying without any real explanation, you know, the building's not moved to another location, the share increased dramatically year over year, which shouldn't have been the case probably.

Rebecca Woods

That's right. So at year's end, when there was a truing up of what portion was the tenants, for example, share of their taxes, insurance, was one line item, and that number jumped pretty remarkably. And so in discussions with the landlord, I surmised before, but then we confirmed with the landlord that the landlord predominantly had properties located in Florida, and they had a pooled risk, which, by the way,

is one way to reduce your insurance cost if you're an owner of property is to pool the risk. But what that did for this tenant, not in Florida, was it radically increased their share. Now we look closely at the language in the lease, and we were able to come to a resolution that was much more tenant friendly, because the language in the lease keyed the cost of the tenants share of insurance to what insurance should cost for that tenant in that location. So listen, it's again, it's a double sided coin. On the one hand, tenants should be looking out for language like that. That would help them to advocate, particularly if they're in a not Florida type location, you know, and a location like outside of Texas, California, Oklahoma, Florida, New York, some of the hot zones where property insurance has gotten pretty egregiously high. If you're a tenant in those locations, you're going to want to look carefully at your lease language, either at lease opening or renewal, to see if you can renegotiate for cost of insurance to be applied to you that are commensurate with your locale. Conversely, if you are a landlord, you're probably going to want to reduce your insurance costs by pulling risk. And then I suppose if individual tenants are coming at you for reductions because they're not in those locations, then that's something to negotiate.

James O'Brien

Yeah, it's funny. I could see it working both ways, where you know, if your tenant was located an area that's not at high risk, now that the landlord is suddenly pooling its insurance expenses across different states. You know, your insurance goes up, but if you are a tenant in Florida, you might want your landlord to pool the risk with its properties that are located elsewhere to help bring down the insurance for you. But, yeah, that's interesting. It's good for tenants to be aware of that language, I think it gets glossed over a lot, and to make sure you've got the audit rights to be able to look into what's happening as well.

Rebecca Woods

I do believe that insurance and indemnity provisions are the unsung heroes in leases and in commercial contracts generally. Now I operate a lot in those spaces as a leader, but here's my exhortation that. Business people who are listening make sure you or your lawyers on your behalf are not just plunking in the standard boilerplate language that you've been using for years, because you can, you can gain a lot of protections in your contracting and shifting of risk by being careful about what your indemnity and your insurance provisions say. And they're, they're usually interrelated as well.

James O'Brien

Right? Yeah, no. And I do think that's an area where, you know, people tend to gloss over it. You know, there's often moved to just sort of pass the insurance provisions on to the insurance broker or the risk manager at the company, and not to really think through how they integrate with the indemnity provisions, for example. And often client size sort of glass so, you know, they kind of get glassy eyed when you talk to them about the insurance indemnity, they're like, oh, that's a legal comment. You deal with that.

Rebecca Woods

That's absolutely true, and I will observe that risk managers have a lot of other things going on. And while you might expect that they're the ones on top of that, in my experience, that's a presumption that that isn't necessarily fair. So I would encourage people to focus on the boring, because they can be worth a lot of money.

James O'Brien

Well, as I said, insurance is a really exciting topic, so I can't imagine why people don't want to dig into it. Well, I mean, I think you've touched on this a little bit, but as we wrap up, what do you think the market is going to look like going forward for commercial real estate insurance?

Rebecca Woods

Well, as far as what I'm seeing, the prognostications are that commercial, general liability is going to just keep going up. And that's a real pain point, because unless you're in a physical location where your real property is going is subject to being destroyed or damaged, and there's certainly lots of swaths of the country where that is the actual greatest risks that businesses are seeing are commercial, general liability, things like the slip and falls, you know, those, those bombshell verdicts against entities, those are hitting their commercial general liability, not their property insurance, and so those premiums are expected to continue to go up very significantly. And that's where you get into that path of captive insurers and self insurance, because that's more viable. Otherwise, property insurance is thought to maybe kind of stabilize, although that's a weird version of the word stabilize. I'm seeing it in the market literature, because it's still going to go up. Ineluctably. It will go up, you know, 3, 5, 7, percent, but probably more on the order. So far, we're thinking of 3 to 5% rather than the 6, 7, 8, percent that we've seen in recent years. So that will be helpful in some stabilization in the excess layers and in the reinsurance market for property, and there are more market entrants, weirdly, same with cyber insurance, which I find completely inexplicable, because the claims are going up, but there is more market competition on the insurance side that will help stabilize, but nevertheless, we're still going to see increased premiums. So entities, folks entering into negotiations to purchase property, that's those are things. So you're just going to have to figure out how to make sure they pencil out.

James O'Brien

Right. Interesting, yeah, obviously a complicated topic. I guess you know, stabilization is better than dramatic increases, so that's a good thing. We're at the end of our time, so we'll go ahead and wrap up here. Rebecca, thanks for joining us today for the 75th episode, for sharing your insights about the current state of the insurance markets. Thanks as well to our listeners for tuning in, and please keep an eye out for future episodes until then, be well.

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