'It Shut Down The Deal': High Multifamily Insurance Rates Threaten Transactions, Strain Budgets

February 6, 2024 | Maddy McCarty, Houston (https://www.bisnow.com/author/maddy-mccarty-622964) (mailto:maddy.mccarty@bisnow.com)

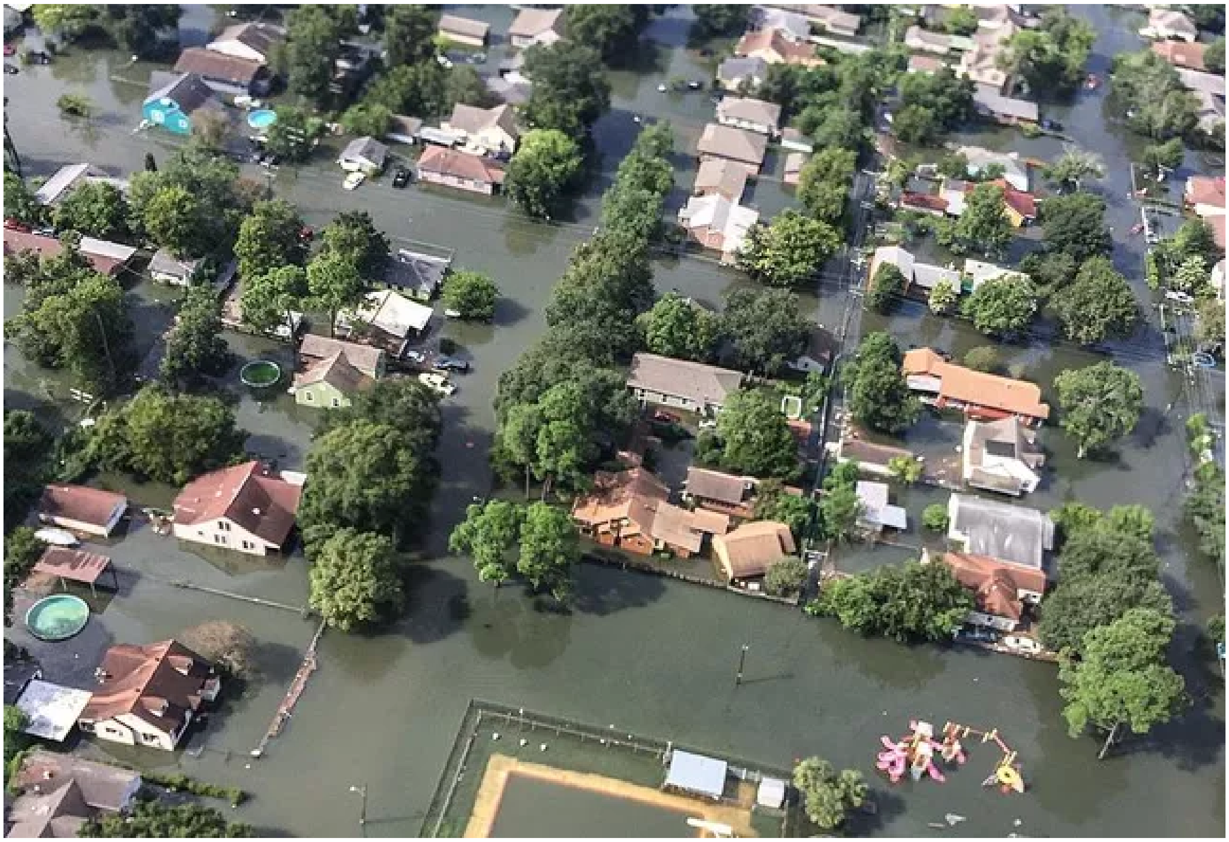
When Terri Clifton began sifting through insurance policy renewal offers for Better World Properties (https://www.bisnow.com/tags/better-world-properties)' multifamily assets last month, she felt a moment of relief that this year's double-digit increases came in far lower than last year's 100% rate hike. That passed when brokers told her she should be pleased to see a mere 30% increase.

"Explain to me exactly what I'm supposed to be so happy about. The fact that you're increasing it even more?" said Clifton, president of the Houston-based apartment management and ancillary services firm as well as a Houston Apartment Association advisory board member.

Insurance prices are growing faster (https://urbanland.uli.org/development-business/a-critical-safety-net-insurance-availability-and-affordability-reach-crisis-levels) for multifamily than any other commercial real estate asset class, with national operators reporting a 26% rise (https://www.bisnow.com/national/news/multifamily/multifamily-insurance-costs-up-nearly-30-since-last-year-119259) in insurance costs on average from 2022 to 2023 and some being hit with 300% and 400% (https://www.costar.com/article/1944537338/heres-how-some-apartment-pros-may-deal-with-higher-interest-rates-insurance-costs) increases.

The rise is most acute (https://www.insurancejournal.com/magazines/mag-features/2023/10/16/743890.htm#:~:text=The%20multifamily%20and%20rental%2 in catastrophe-prone regions, especially Texas, Florida and Louisiana. But multifamily owners and operators everywhere are feeling the pain of high rates, limitations in coverage, hikes on deductibles and a shrinking private insurance market.

That rapid ascent is expected to continue into 2024, and operators told *Bisnow* that spiraling costs could kill deals, reduce returns on investments, force foreclosures and discourage investors from even entering the multifamily space.



"If we do have more natural disasters, if insurance companies take more losses this year and next year and prices continue to go up, it's completely unsustainable, and no one is going to be able to make their properties work," said Gautam Goyal (https://www.bisnow.com/tags/gautam-goyal), CEO of Houston-based private equity firm Three Pillars Capital. "You cannot increase rents by the same margin. There's no way to keep up with those expenses."

Goyal sees trouble ahead for the multifamily industry if there is not some form of relief on the way, including the government stepping in with blanket insurance coverage.

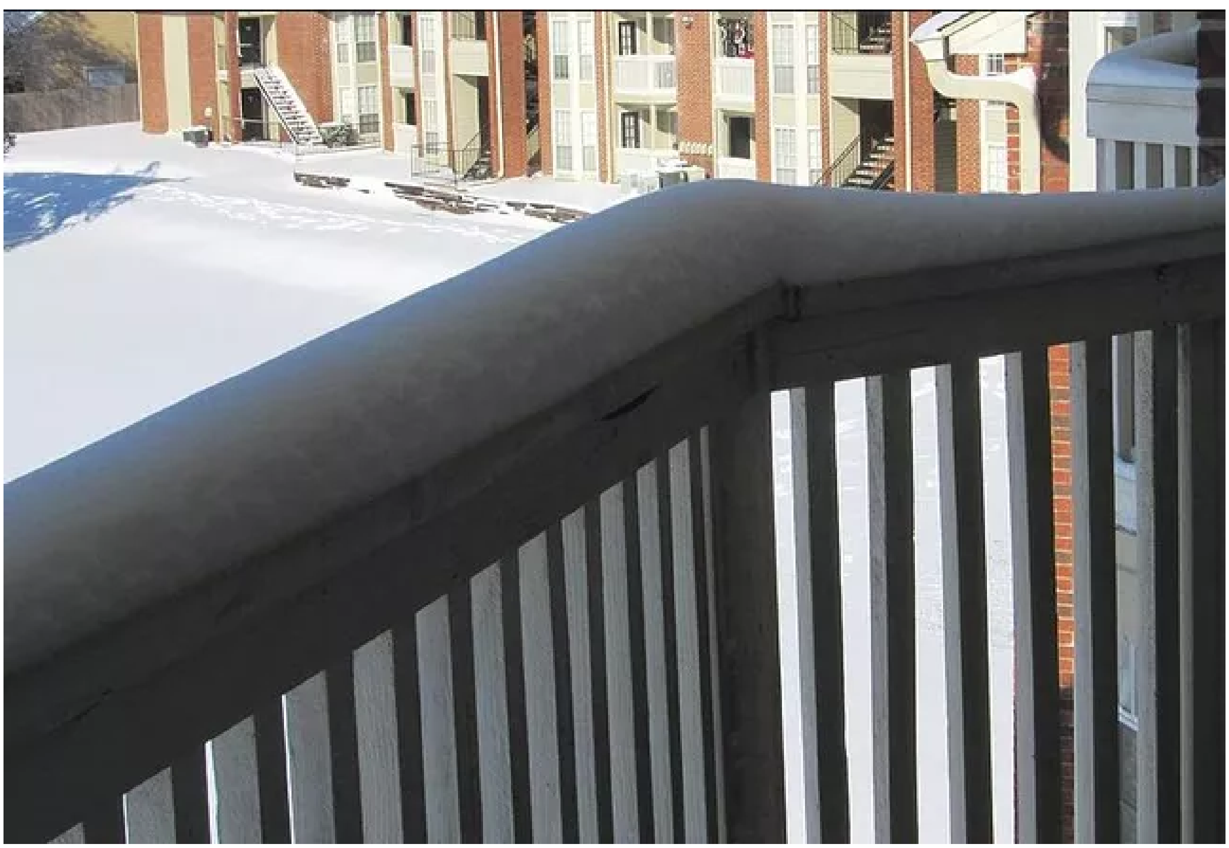
In Texas, natural disasters that required huge insurance payouts, like Hurricane Harvey (https://www.bisnow.com/tags/hurricane-harvey) in 2017 and Winter Storm Uri (https://www.bisnow.com/tags/winter-storm-uri) in 2021, are still having expensive consequences. Insurance companies are also grappling to account for inflation, rising property values and the increased cost of repairs due to supply chain (https://www.bisnow.com/tags/supply-chain) disruptions and labor shortages (https://www.bisnow.com/tags/labor-shortages).

Coastal areas like Houston are seeing the impact most significantly, said Melanie French (https://www.bisnow.com/tags/melanie-french), CEO of Dallas-based RR Living (https://www.bisnow.com/tags/rr-living), which has dozens of multifamily assets nationwide.

"Corpus Christi is a market where we have five assets, and it is daunting, some of the insurance costs there," French said. "They're putting in more policy limitations there and increasing the deductibles, yet [the cost is] still going up."

At the National Multifamily Housing Council (https://www.bisnow.com/tags/national-multifamily-housing-council) Apartment Strategies Conference in San Diego last week, attendees were told the latest figures show apartment insurance rates are up 32% year-over-year, French said.

"I can't imagine there's a multifamily operator out there who has not been impacted by the rising insurance costs," she said.



Those costs are killing deals, French said, slowing down the acquisitions and the number of transactions that have been trading.

Houston's multifamily sales fell 74% from 2022 to 2023, largely due to insurance premiums and the high cost of capital, according to data from Colliers (https://www.bisnow.com/tags/colliers) and MSCI (https://www.bisnow.com/tags/msci) Real Capital Analytics. Houston multifamily investment sales in the fourth quarter of 2023 tallied up at $510M, which represents the second-lowest quarter in a decade.

"I talked to somebody a few weeks ago who had a property in Miami. They had underwritten for $4K to $5K a unit for their insurance. When they finally got the final quote, it was $8K a unit," French said. "Literally, it shut down the deal, and they weren't able to buy. It's getting rough. We're going to see more and more of that."

In Houston, prices are up to $2.5K per unit per year, Better World's Clifton said, which is by far the highest she's seen in her 35 years in the industry. When she started in the business, rates were about $300 per unit annually.

Clifton worries the issue will go full circle and hurt renters who might struggle to afford spiking rents. But runaway insurance costs will have a major negative impact on those who invested in the assets since they are too high to be passed on via rent hikes alone, she said.

"If no one wants to invest in real estate, they're not going to buy apartment complexes, so no more are going to be built," Clifton said. "You talk about a housing shortage now. Who wants to invest in something they can't make a return on?"

Brokers are less than optimistic about when rates might come back to earth.

Hanin Al Qoreishy, founder and CEO of Houston-based brokerage Legacy Insurance Advisors, said her best guess would be the end of 2024, though she expects things to go from bad to worse in the short term. And they are already quite bad, she said.

"I have so many investors that have gone into foreclosures," Al Qoreishy said. "My business partner owns a mortgage company and has issued so many foreclosures on properties as well. I can say that it's not going to get better any time soon. It's probably going to get worse mid-year."

Much will depend on the frequency of natural disasters and the number of claims being submitted, said Melvin Johnson, a business insurance adviser for Marsh McLennan (https://www.bisnow.com/tags/marsh-mclennan).

"They can only go off of algorithms and the math behind what's happening," he said. "But if you are able to develop some type of relationship, and they know a little bit more about you and your properties and how you run them, that is going to show a little favor when it's time for a renewal to be handed down."

Assets in higher-risk locations, whether that is due to crime, flooding or another reason, are simply going to cost more to insure, Al Qoreishy said.

"Your job as an investor is to lower that risk for the insurance companies. You get a lower rate if you're a lower risk for them," she said. "At the end of the day, they don't want to pay out."

Al Qoreishy recommends upgrading property security, researching properties before purchasing and being aware of past claims and losses, adding that insurance brokers help in this area. A relationship with an agent is more important than ever to avoid risky properties with bank-breaking rates, he said.

RR Living avoids renewing insurance policies during hurricane season (https://www.bisnow.com/tags/hurricane-season) because that is when rates are at their highest, French said. It also finds discounts by insuring multiple properties on one policy, replacing older windows with wind-resistant glass, upgrading wiring and raising foundations on new construction in flood-prone areas.

For investors, Goyal suggests talking to lenders to "get them to be more reasonable" about insurance policy requirements.

"A lot of them had preset requirements and what they want to see for insurance," he said. "The [pricing] has substantially changed, so we're starting to see some lenders come down on that."

That is another thing an insurance broker can help with, Johnson said, adding buyers need to review contract language carefully to "see if we can push back."

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See Also: Douglas Emmett Gets $550M Construction Loan Connected to Westside's Barrington Plaza (/los-angeles/news/multifamily/douglas-emmett-gets-550m-construction-loan-connected-to-westsides-barrington-plaza-122778)

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