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UNITED STATES INSURANCE MARKET REPORT 2016

REAL ESTATE AND HOSPITALITY

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FOREWORD

As part of our commitment to keeping you informed, Marsh is pleased to present you with this excerpt regarding the real estate and hospitality industry from our *US Insurance Market Report 2016*. Through data and analysis, it provides a snapshot of current market conditions and risk trends across major lines of coverage and industry/specialty sectors. The report reflects the experience of Marsh insurance professionals who work daily with the global insurance marketplace and provide clients with risk management advice.

With 2016 under way, the global insurance marketplace appears to be heading in the general direction of soft pricing, reflecting insurer capacity, competition, and relatively low catastrophe losses. At the same time, the insurance industry will continue to be affected by macro dynamics, including global economic, political, regulatory, technological, and environmental developments.

In addition, the insurance industry is also experiencing some significant developments that bear watching throughout 2016, including:

- Large-scale mergers and acquisitions.
- Executive leadership changes.
- A reduction in and changes in underwriting appetite at several companies.
- Some insurers' disposition of unprofitable segments.
- Recent announcements regarding potential and actual reinsurance underwriting.

These developments may ultimately produce positive outcomes, such as a prolonged healthy, competitive market with higher levels of innovation, new product offerings, and improved service.

Companies of all sizes and in all industries around the world choose Marsh for our breadth and depth of experience, expertise, and capabilities. These traits are critical in a volatile market, as is our ability as a trusted strategic advisor to help you navigate complex risk challenges and assess and recommend markets.

We thank you for the trust you place in Marsh every day. Should you have any questions about this report or the industry and market environment, please do not hesitate to reach out to your Marsh representative.

Best regards,

Rob

Robert Bentley
President, US and Canada Division

EXECUTIVE SUMMARY

Following are some key takeaways from Marsh's *US Insurance Market Report 2016*.

RISK ISSUES

Cybersecurity

Cybersecurity is now a mainstream business concern across all industries as most companies have either been the victim of a cyber-attack, conducted business with a company that has been attacked, or expect to be attacked at some point. There is a realization that cybersecurity needs to be managed across the enterprise. From individual employees to the board of directors, everyone has a stake in cybersecurity.

Drones

Insurers are paying increasing attention to the use of unmanned aerial systems — drones. Coverage for the risks presented by drone use may be excluded from casualty policies, and insurers are concerned about personal and advertising injury risks related to drones, although bodily injury and property damage coverage may also apply. In 2016, organizations that use drones may be expected to answer detailed questions from insurers including, but not limited to, questions about drone size and intended purpose.

Mergers and Acquisitions (M&A)

M&A activity in 2015 was exceptionally high in many industries, including insurance, health care, and communications, media, and technology. Activity is expected to be high again in 2016, barring any unforeseen changes. Among the risks heightened by M&A activity are environmental exposures, including legacy pollution issues; technological risks, such as integration of systems, data protection, and cybersecurity; and regulatory issues.

INSURANCE COVERAGE ISSUES

Property

- The US commercial property insurance market continued a two-year softening trend in 2015, one that is expected to continue into 2016, barring unforeseen changes in conditions. Rates are generally decreasing for buyers as catastrophe (CAT) losses were again low in 2015, insurer competition is at a high level, and alternative sources of capital are expected to continue to buoy the market.
- The quality of data that insureds submit to underwriters will continue to play a significant role in determining property insurance pricing, particularly regarding catastrophe risks.
- Cyber issues are playing out in property policies as business interruption losses stemming from cyber-attacks are an increasing concern for many organizations.

Casualty

- The US casualty insurance market generally softened in 2015 and, barring unforeseen changes, these conditions are likely to continue into 2016.
- Automobile liability remains among the most challenging of casualty areas. Nearly half of all auto liability clients renewed with rate increases in the fourth quarter of 2015, with trucking exposures facing a particularly difficult market.
- The workers' compensation insurance market continues to improve, with generally favorable conditions for buyers. Prescription drug prices remain a cost management concern.

Financial and Professional

- Entering 2016, demand for cyber insurance continues to grow across all industries and segments. Demand for protection against data breaches remains strong as concern over business interruption risks is growing. Capacity will continue to increase for most classes, barring unforeseen changes, but organizations should be prepared to fully outline their cyber security controls for underwriters for the best results.
- Employment practices liability insurance rates generally declined in 2015 and are likely to do so again in 2016, barring unforeseen events. Wage and hour claims filings have increased, as have related insurance offerings.
- Directors and officers (D&O) insurance rates are likely to continue to decline in 2016, barring unforeseen changes in conditions. Insurer and broker coverage innovations are also expected to continue.

Aviation

- The airline insurance market is expected to remain soft in 2016, barring unforeseen events. In the fourth quarter of 2015, most buyers renewed with decreases of between 15% and 25%. Competitive markets are also expected for general aviation and aerospace manufacturers.

Captives

- In early 2015, the Internal Revenue Service (IRS) included the formation of small captives on its annual list of questionable tax avoidance strategies. Any company seeking to form a small captive should follow a strict and detailed approach to ensure compliance.
- More captives may access terrorism insurance in 2016 as awareness of the potential benefits increases.

Employee Benefits

- Employers predict that in 2016 their health benefit cost per employee will rise by 4.3%, on average, according to Mercer, one of the Marsh & McLennan Companies.
- Employers are becoming more creative in how they support workforce health. For example, about one-fourth of large employers (24%) encourage employees to track their physical activity with a "wearable" device.

Energy

- Overall energy insurance market capacity increased in 2015, putting downward pressure on pricing. Barring unforeseen events, soft market conditions will likely continue in 2016.
- Energy companies have generally increased their focus on cybersecurity, including on regulations and adherence to certain contractual risk allocations to better manage each party's risk and exposure to cyber loss.

Environmental

- Barring unforeseen changes, the soft environmental insurance market conditions seen in 2015, which were driven by abundant capacity, are likely to continue in 2016.
- The rapid pace of M&A activity has led to an increase in environmental insurance purchases to help facilitate transactions.

Entertainment

- The market for entertainment and events insurance was relatively soft in 2015.
- Drone use and terrorism risk are expected to be prominent issues in 2016.

Marine

- The marine market significantly softened in 2015, largely driven by a continued influx of capacity, a soft reinsurance market, and reduced losses.
- A high number of mergers among marine underwriters in 2015 did not affect the overall market.

Political Risk

- Despite significant global political turmoil and violence, political risk insurance rates generally declined in 2015 and should do so again in 2016, barring a significant change in conditions.
- High risk areas are exceptions. For example, it is difficult to obtain coverage for Russia, while portfolios that included Turkey or Brazil generally saw increases of about 10% in the fourth quarter of 2015.

Surety

- Surety market outlook for 2016 is positive, assuming continued strength in the construction industry.

Trade Credit

- The market for trade credit insurance is expected to remain generally favorable for buyers into 2016.
- Larger rate reductions were possible in 2015 for portfolio programs covering multiple debtors (as opposed to single-debtor programs).

Note: For specific insurance market and risk trends by industry, see the "Industry Specialties" section of this report.

Real Estate and Hospitality

AHEAD IN 2016

Competitive rates likely across most lines.

Habitational segment remains challenging for casualty insurers.

Growing interest in cyber insurance solutions.

INSURANCE MARKET CONDITIONS

COVERAGE	SEGMENT	RATE CHANGE Q4 2015	RATE CHANGE Q4 2014
PROPERTY	NON-CAT-EXPOSED ORGANIZATION	10% DECREASE TO 5% DECREASE	10% DECREASE TO 5% DECREASE
	MODERATELY CAT-EXPOSED ORGANIZATIONS (1% TO 30% OF VALUES IN CAT ZONES)	15% DECREASE TO 5% DECREASE	15% DECREASE TO 5% DECREASE
	LARGELY CAT-EXPOSED ORGANIZATIONS (MORE THAN 30% VALUES IN CAT ZONES)	15% DECREASE TO 5% DECREASE	12% DECREASE TO 5% DECREASE
CASUALTY	UMBRELLA/EXCESS LIABILITY	5% DECREASE TO 5% INCREASE	FLAT TO 5% INCREASE
	GENERAL LIABILITY	5% DECREASE TO 5% INCREASE	FLAT TO 5% INCREASE
	WORKERS' COMPENSATION	5% DECREASE TO 5% INCREASE	FLAT TO 5% INCREASE
	AUTOMOBILE LIABILITY	FLAT TO 5% INCREASE	FLAT TO 5% INCREASE
MANAGEMENT LIABILITY	PUBLIC REITs	5% DECREASE TO FLAT	5% DECREASE TO 5% INCREASE
	REAL ESTATE INVESTMENT ADVISORS	5% DECREASE TO FLAT	5% DECREASE TO 5% INCREASE
	REAL ESTATE OPERATING COMPANIES	5% DECREASE TO FLAT	5% DECREASE TO 5% INCREASE

The above represents the typical rate change at renewal for average/good risk profiles.

Market Commentary

PROPERTY

The property insurance market for commercial real estate owners and operators remained favorable to buyers in 2015, driven by an oversupply of capital and market competition. In the fourth quarter, renewal rates were generally down 5% to 15% for most buyers, including hospitality and gaming organizations. However, conditions were less favorable for portfolios with poor loss experience. Rate reductions are expected again in 2016, barring unforeseen losses. Insurers generally are offering significant rate reductions to retain existing accounts. Also:

- Insurers are seeking to hold all other peril deductible levels constant in order to avoid picking up more attritional losses.
- Catastrophe percentage deductibles are decreasing for many buyers, most notably around named windstorm.
- Following passage of the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA) several real estate companies switched their terrorism programs from standalone placements into “all risk” property placements.

Property insurance market conditions for pure multifamily portfolios were generally favorable for buyers in 2015. In the fourth quarter, rate reductions of 5% to 15% were typical, depending on loss experience. The number of insurers willing to quote at $10,000 or $25,000 deductibles and retentions is limited. Multifamily owners and operators able to take higher deductibles and/or retentions (of $100,000 or more) are generally seeing larger rate reductions.

CASUALTY

The casualty insurance market conditions were competitive for most real estate risks in 2015. In the fourth quarter rates generally renewed:

- Flat to up 5% for commercial real estate.
- Flat to up 10% for habitational properties.
- Flat to down 5% for hospitality clients.

Individual buyers' experience was generally influenced by loss histories, year-over-year exposure changes — including changes in occupancy type — and length of time since previous marketing efforts. Some jurisdictions — including New York — are also drawing greater underwriting scrutiny. Diversified real estate portfolios saw ample capacity in the marketplace, and competition tempered significant rate increases. In some cases, buyers were able to secure rate reductions.

The habitational segment remains a challenge for insurers and general liability insurance rates increased faster than for any other segment. Few insurers are willing to write portfolios with significant habitational components, particularly on a guaranteed cost basis; this trend is expected to continue in 2016, barring any unforeseen changes. Many insurers are now requiring maintenance deductibles, which some carriers will use to mitigate potentially larger rate increases. Other concerns for underwriters include:

- The legalization of medical and recreational marijuana, which could create general liability claims involving tenants.
- Physical violence on properties, for which owners are increasingly being held responsible by courts.

The student housing sector generally experienced rate increases in 2015; among other risks, insurers are concerned about potential liability related to tanning beds and fitness equipment. Standalone hospitality portfolios also saw greater rate increases than mixed portfolios, driven in part by growing legionella claims. However, rate decreases were still possible for hospitality clients with especially strong risk profiles.

FINANCIAL AND PROFESSIONAL

The market for management liability insurance, including directors and officers liability, softened in 2015. New capacity continues to enter the market and competition remains strong. In the fourth quarter, renewal rates were typically flat to down 5%. Results varied, however, based on individual risk profiles.

Despite generally favorable conditions, insurers are concerned about trends in the real estate investment trust (REIT) sector. For example, consolidation among REITs has led to an increase in merger objection litigation. In addition, activist investors are emerging in the REIT sector, often seeking the sale of assets, changes in dividend policies, board seat nominations, or even wholesale change of company management.

ENVIRONMENTAL

The environmental insurance market remained competitive for most real estate and hospitality industry buyers in 2015. Capacity remains abundant, and insurers are competing aggressively for most accounts. In the fourth quarter, rates were generally flat, although rate reductions were possible for buyers with strong risk profiles. A competitive and generally stable market for most insureds is expected in 2016, barring any unforeseen changes.

Real estate companies are showing a tendency toward redevelopment of existing properties, which can present significant environmental risk. Insurers' appetite for redevelopment risk is limited; some insurers are seeking rate increases for portfolios that include properties being redeveloped on brownfield or industrial sites.

Insurers are also concerned about a rise in mold and legionella claims for hospitality and multifamily clients. Insureds that have suffered significant losses may face a more difficult market.

RISK TRENDS

Cybersecurity

A recent data breach involving a large multifamily property operator has raised concerns about data and privacy exposures for real estate companies. Multifamily property owners and operators and third parties that they work with often retain personally identifiable information about residents and employees, including Social Security numbers. Interest in cyber insurance is especially strong in the hospitality and gaming sector.

Data Quality

To position themselves to achieve the best possible outcomes at renewal, real estate companies should work with their insurance advisors to review and improve the quality of their property and casualty data:

- Location, occupancy, construction type, and other property data are critical to catastrophe modeling.
- Casualty insurers expect insureds to provide detailed exposure data, including occupancy rates and payroll information, historical loss data, and workers' compensation class codes.

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