

NEWS BRIEF

Provided by: SCS Agency Inc

Construction Costs Outpacing Property Rate, Limit Increases

Property insurers are not raising coverage limits and rates to keep pace with inflating construction costs, according to a Moody's Investors Service report.

Rising costs for construction materials and labor means elevated loss severity for insurers because repair and replacement work are more expensive. "Higher costs for construction materials and labor have caused elevated loss severity for homeowners and commercial property insurers, which will lead to higher ex-catastrophe combined ratios over the course of 2022," Moody's wrote.

Materials and labor costs grew 26.7% and 5.5%, respectively, in the first four months of 2022 compared to the same period of 2021, according to government data. Supply chain disruptions and labor shortages also caused construction delays.

Commercial property insurers expect to raise pricing by about 6.5% this year, and homeowners insurers expect rates to increase about 7%, according to a Moody's survey. Homeowners insurers have raised rates between 3% and 5% annually since 2015. Commercial property rates went up an average of 9% last year and 13.5% in 2020.

Moody's provided several reasons that explain why insurers may not be keeping pace with construction costs. Their coverage software may not adequately account for the cost increases. Insurers may increase coverage by an average annual inflation rate to smooth out construction cost volatility. They may worry sudden, large increases will prompt insureds to shop around. Also, since insurers must wait until policy renewal to adjust rates, there can be a delay between an uptick in costs and premium changes.

Moody's said it expects homeowners insurance combined ratios to deteriorate about 2.5 points in 2022. The increase could be as high as 7.5 points, depending on the severity of increased loss costs. It likewise expected commercial property insurance combined ratios to worsen by about one point but could deteriorate by about 6.5 points under a more dire scenario.

On the positive side, the insurers that Moody's rates "... have ample capital to withstand potential underwriting losses in homeowners and commercial property lines stemming from inflation" and manage catastrophe (CAT) risk through exposure limits, reinsurance and other underwriting initiatives. Property insurers benefited from low CAT losses in the first quarter of 2022.

