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General News

Climbing rates to subside

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Owners of apartment buildings in the Oklahoma City metro - as in other regions nationwide - may have felt the sting of rising insurance costs over the last three years.

But while insurance costs to apartment owners have doubled and sometimes tripled since 2000 due to a confluence of market events, industry participants say there's light at the end of the tunnel. Insurance professionals expect the rise in rates will subside in the next year as apartment insurers gain financial equilibrium.

"I think what we're going to see is a fairly flat market for the next two or three years, with some discounts for people who have larger schedules and a clean loss history," said Kelly Miller, president of Professional Insurers Agency in Oklahoma City.

Miller said insurance companies, in an effort to return to profitability, three years ago started to increase rates that go into calculating premiums. At the same time, property owners were forced to increase the dollar value of their insurance coverage to account for a sudden rise in the replacement cost for insured properties.

The combination of rising insurance rates and property values amounted to a "double hit" for property owners who upon renewing their insurance policies found their insurance costs had more than doubled, he said.

"In the last three years, the rates for property insurance for apartments has anywhere from doubled to tripled," Miller said. "You take the rate and double it; you take the values and double them and you've got a double hit."

Miller offered an example of the rise in insurance rates for a typical apartment property that today would be valued at \$5 million.

Four years ago, the owner of the property likely would only have been required to insure the property for \$2.75 million, based on the lower valuations at the time. Miller said the apartment owner would likely have paid \$10,000 in premiums with a \$5,000 deductible.

Insurers today are likely to require more coverage, up to the full \$5 million replacement value. Taking into account higher rates and higher coverage, the same property owner today might have to pay \$30,000 in premiums with a \$10,000 deductible, he said.

Adding to the higher costs, many insurers also now require a higher deductible if property in Oklahoma or Texas is damaged by wind or hail. And there are plenty of wind and hail damage claims in Oklahoma. "So not only might you have to insure your property at a higher value, in many cases there's a higher deductible for wind and hail exposure," says Miller.

Property owners have responded to the rising rates in several ways, he said.

Miller said more apartment owners - many of whom might have done business primarily with a direct writer of insurance in the past - are now shopping around for competitive rates. That has sent a flurry of new business to people like Miller, an independent insurance firm that represents multiple carriers. Many apartment owners also have chosen to accept higher deductibles on their insurance policies as a method to control premiums, he said.

Miller said the higher insurance costs may have a further impact on apartment owners, if they are marketing their property for sale.

Apartment properties are typically sold at a price that is based on a multiple of the projected revenue that the property will produce. As insurance costs rise, the projected revenue from the apartments is

decreased, and consequently reduces the value of the apartment complex in the eyes of potential buyers. An apartment buyer might pay eight times the cash flow of an apartment property to acquire the building. Hence, a \$25,000 increase in insurance costs for a \$3 million apartment complex might decrease the value of the property by \$200,000 in the eyes of the buyer.

"You see people who go out to buy properties, and they negotiate the cost & then they look at the insurance costs. And all of a sudden, the sales price doesn't look that good," Miller said. "They find that out toward the end of the process of buying (an apartment property), and the deals fall through."

Mike Buhl, a broker with Commercial Realty Resources Co. in Norman, said he has not seen any evidence that the higher insurance rates have prevented multifamily transactions.

What Buhl has found, however, is that it may take a greater level of effort to find the necessary insurance coverage that is acceptable to an apartment buyer.

"You have to shop around to many more companies than you had to in the past to get acceptable quotes," he said. "Generally, the only time there's a problem is if you have any kind of loss runs on your property. If you're working on a property where you have an owner that has filed claims in the recent past, you may have problems getting decent quotes. We've had to shop around, but we've been able to find insurance and get competitive quotes."

"We haven't had a deal fall through because of insurance."

On the other hand, says Buhl, some property owners have trouble selling their multifamily properties because of the deferred maintenance and previous loss runs on a property.

"I'm sure those can result in problems that would prohibit the sale," he said.

Buhl said buyers of apartment buildings have become more aware of the issues of insurance and taxes when doing their due diligence ahead of acquiring a new property. As a result, more buyers have started to ask questions early in the process about the cost of insurance.

"They want to know what premiums the current owner is paying and who it is with," he said. "Buyers are doing more due diligence."

The need to find competitive insurance rates also has prompted more property owners to shop around for the best deal and to accept less favorable terms than they might have accepted three years ago. Some owners, for instance, are compensating for the higher premiums for coverage by increasing their deductibles.

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