

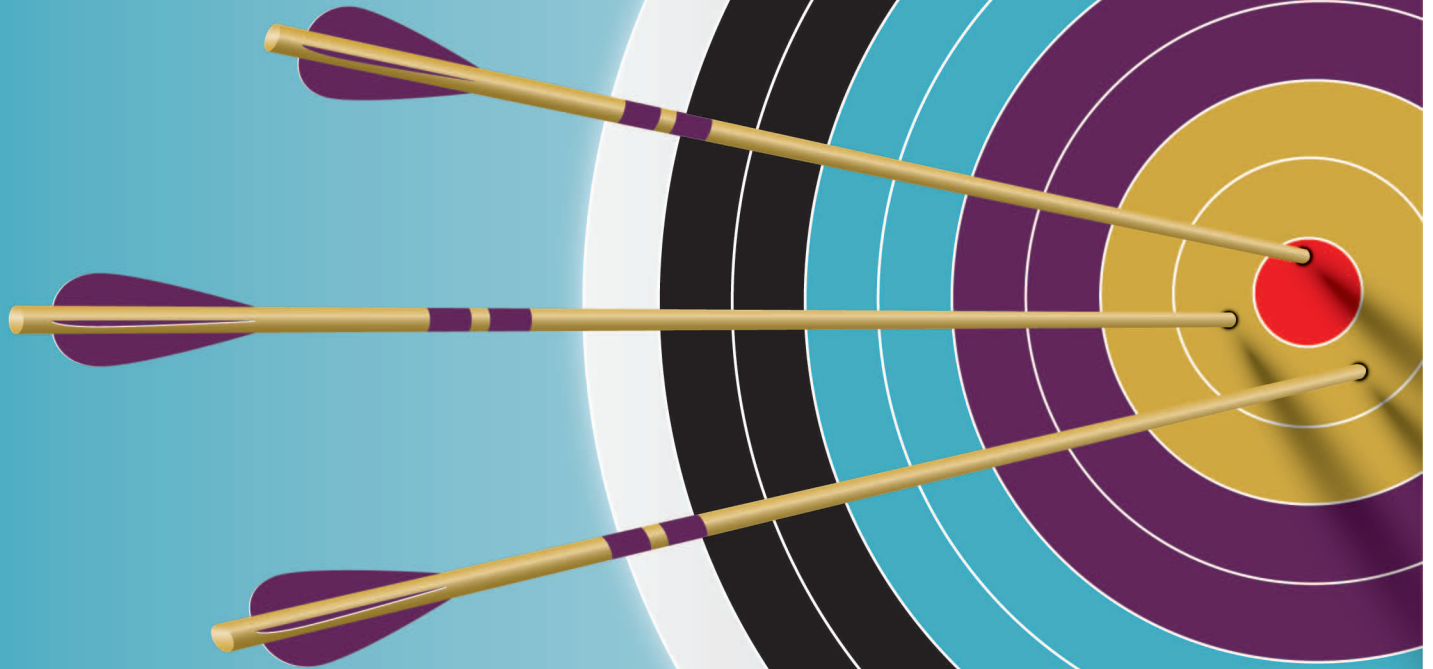
NAREIM

SPRING 2024

BEST PRACTICES SHARED | VALUE ADDED

dialogues

Targeting **RETAIL CAPITAL**



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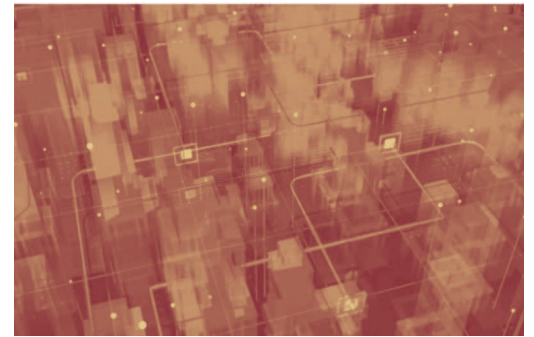
Real estate investment managers seeking alternative sources of capital have a new avenue in the retail investor. While there is appetite for private market alternative products, meeting it would require managers to structure products differently, as well as have a distribution platform that can reach and service these high-net-worth and accredited individual investors. NAREIM spoke with *Bert Crouch* of *Invesco Real Estate* about building and operating a retail capital capability and what managers should know about accessing this channel.

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Insurability *through* property resilience *data*

Fine-tuning resilience assessments and providing proper data to insurers could ease insurance challenges for commercial real estate investors.

By Jessica Wright,
Partner Engineering and
Science

The exponential increase in insurable losses due to natural disasters and severe weather events has led to a crisis in the property insurance market, with premiums skyrocketing and policy cancellations, especially in coastal regions. In addition, rising construction costs and labor shortages have resulted in higher replacement values. Underwriting has become an arduous process, with higher levels of scrutiny required to establish insurable value and assess risk. Some assets, particularly those in CAT (catastrophe-prone) areas, may no longer be insurable at all.

For the commercial real estate (CRE) industry, the insurance crisis impacts how — and which — deals get done. Insurability and insurance premiums are now a priority consideration in acquisition underwriting. For insurers, the pool of properties that meet risk criteria is shrinking. As a result, both investors and insurers are eager to find ways to

quantify and minimize climate-related risk exposure.

Recently, property owners, insurers and due diligence consultants have been working together to fine-tune resilience assessments to facilitate insurance underwriting and help CRE owners secure reduced premiums and/or coverage for properties in CAT-prone areas.

From an engineering standpoint, there are many ways to reduce exposure to severe weather risk. Buildings respond differently to severe weather based on design and construction, which can be modified for greater resilience. By documenting construction and modifications related to property resilience, property owners not only understand their exposure; they can provide data to insurers to support insurance risk analysis as well.

**Demonstrate resilience,
quantify risk**

Until the last ten or so years, insurers

ascribed risk status according to location, using historic weather data, flood maps, etc., with little consideration for engineering factors outside of basic construction type. Today, insurance providers examine resilience factors when determining whether — and for what price — to cover assets in high-risk areas. Generating data to inform insurance underwriters of key resilience-related attributes allows insurers to better quantify risk.

For example, when seeking coverage for a building in a flood zone, a property owner could demonstrate reduced risk of flood damage to the electrical room by documenting the following:

- Susceptible equipment is located above predicted flood levels with waterproof enclosures to address flood concerns.
- Clear roof drainage including condensate lines from HVAC equipment and proper drainage away from the foundation.
- Management routinely ensures that water does not pool on the roof or the building perimeter.
- Swales move stormwater runoff away from the property.
- Gravel or brick pavement in areas nearest the building (instead of concrete or asphalt) supports better water percolation into soils.

The more data insurers have regarding the construction and resilience features of each property, the better they can predict how buildings will perform in severe weather events. In the absence of data, underwriters must make assumptions based on average attributes of buildings in the area and set premiums accordingly.

For properties with resilience measures in place, replacing unknowns with quality data can help control

premiums. In a recent presentation to NAREIM members, Pete Romano, EVP and Commercial Insurance Practice Leader for Lockton Companies, stated: “for every dollar of known or expected loss transferred to an insurance company, they will charge you two to three times in premium!”

Customized data for sophisticated insurers

Stung by the astronomical losses of the past few years due to unexpected weather conditions, insurers are becoming increasingly sophisticated regarding risk and resilience factors related to building construction. Much the way previous conflicts and liabilities prompt the addition of increasingly specific and numerous clauses to legal contracts, vulnerability and/or failures of specific building materials and components have led underwriters to scrutinize certain construction details of a property and its systems.

Recently, a developer seeking to acquire a portfolio of 23 buildings in Naples, Florida — very near the site of Hurricane Ian — learned just how granular that scrutiny can be. Beyond the basics such as construction and occupancy class, year of construction, and age/type of roof, the insurer issued a questionnaire requiring detailed information on building components, including cladding (covering or coating) rating, roof sheathing (decking) attachment, and the wind resistance of virtually every aspect of the building envelope. The granularity on wind-related factors included details on roof geometry, roof anchors, roof flashing (metal that directs the water) and coping (sheet metal that caps the vertical wall on a roof), and wind bracing for any rooftop

Potential impact of data on premiums

Pete Romano of Lockton Companies provided the following example of a wood-framed building in Miami, Florida:

Worst case: Poor COPE and secondaries data

- Average annual loss: \$1,000,000
- Premium of \$3,000,000

Best case: Best COPE and secondaries data

- Average annual loss: \$125,000
- Premium of \$250,000

As Romano said: “Construction quality with good secondary modifier data makes all the difference.”

equipment. This insurer had become very savvy to exactly which systems, components and attributes affected their risk exposure, and they would not underwrite the developer’s portfolio without examining each in detail.

In response, the developer added a custom scope to its due diligence assessments for each site. The scope, dubbed an “Insurance Resilience Supplement,” was a supplement to the Property Condition Assessment (PCA) scope already being performed at the 23 sites. The experienced assessors already deployed for the PCAs had the expertise required to complete the insurance questionnaire and were able to gather data for the questionnaire and PCA in the same site visit. These site observations, along with research of historic records, photos and plans, were used to satisfy the insurer’s requirements. Afterwards, the developer noted that the Insurance Resilience Supplement saved “weeks of back and forth” with the insurer, streamlining the process for both parties.

“ To effectively use resilience data to influence insurance outcomes, property owners must provide the kind of data that underwriters use to evaluate risk, namely COPE. ”

A key component to the success of this project lies in tailoring the set of resilience data collected to suit the criteria of the insurance underwriters. The Insurance Resilience Supplement was custom scoped to capture the data necessary to complete the insurance questionnaire.

COPE data and secondary modifiers

While resilience assessments are becoming a more frequently requested scope in the context of acquisition due diligence, the data collected in such assessments can vary. ASTM is currently developing a standard guide for resilience assessments, but the standards determined by ASTM may not satisfy the highly specific and granular data requirements of insurance underwriters. The good news is that as consultants complete these insurance-specific requests for resilience assessments, communication between the insurance companies and engineering consultants informs the scope of future resilience assessments.

To effectively use resilience data to influence insurance outcomes, property owners must provide the kind of data

that underwriters use to evaluate risk, namely COPE (construction, occupancy, protection and exposure) and secondary modifier data.

COPE can be broken down as follows:

- **Construction:** Refers to the materials and methods used in building construction. Different construction types have varying levels of susceptibility to damage from perils such as fire, wind and water.
- **Occupancy:** Describes the purpose for which a building is used. For example, residential, commercial, industrial or vacant properties pose different risks.
- **Protection:** Refers to the measures in place to protect the property from loss or damage. This includes fire protection systems, security systems and other safeguards.
- **Exposure:** Involves the external factors that may increase or decrease risk, such as the property’s location, surrounding environment and proximity to hazards.

Secondary modifier data captures are additional factors that affect risk, such as proximity to a fire hydrant, the claims history of the building or the age of the building.

Telling a better story

In the Fall 2023 NAREIM Dialogues insurance roundtable, Mona Sullivan, Senior Vice President and Insurance Risk Manager for the investment management firm PCCP, LLC, discussed the firm’s annual insurance renewal process in the current insurance climate. She noted that “[i]nsurance companies typically underwrite to the story that you present to the marketplace. Representing your firm with the best possible underwriting presentation is essential.”

Roundtable participants agreed that in the complex, multifaceted process of insuring a real estate portfolio, relationships matter and insurers value clients who demonstrate responsible risk management. Because insurers have limited underwriting capacity, a certain amount of subjectivity comes into play once the numbers are compared.

A risk management program that includes proactive resilience strategies, along with resilience assessments scoped to reflect insurance underwriting criteria, allows managers to deliver a compelling story. When this program is supported by property data, it demonstrates that managers have taken measures to fortify their portfolio against the increasing threat of severe weather events.

According to USI’s 2024 Commercial Property & Casualty Market Outlook, commercial property insurance rates will continue to increase in 2024, but not at the pace they did in 2023: “Our forecast calls for 5% to 15% rate increases for non-catastrophe property with minimal loss history and good risk quality; 15% to 30%+ for CAT-exposed property with minimal loss history and good risk quality; and 15% to 30%+ rate increases for those risks with poor loss history or poor risk quality. (In comparison, both CAT and non-CAT rates increased 25%–150% in 2023.)”

While the insurance crisis is far from over, an ongoing dialogue between investors, insurers and the engineering community regarding the best way to quantify and mitigate climate risk may be the best path to de-escalation over the long term. ♦

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