



Everything New Orleans

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Business insurance costs are hindering recovery

Policies can now cost 10 times as much

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By Rebecca Mowbray

Business writer

Homeowner insurance costs are soaring, but what's happening to business insurance is catastrophic: a combination of less coverage for lots more money that threatens to undermine the region's post-Katrina recovery

Premiums have shot up to as much as 10 times what they were last year. Deductibles on commercial properties, once tens of thousands of dollars, are reaching into the millions. And some companies, unable to get enough coverage for their properties, are forgoing coverage altogether and making plans to foot bills for future damage themselves.

Take the Rathborne Cos., a Harvey real estate firm. Mickey Jones, the company's vice president and chief financial officer, was stunned when he opened an insurance renewal notice for the firm's \$10 million Elmwood warehouse and realized his deductible was jumping from \$10,000 to \$1.5 million.

Jones shopped around for a better offer, but the next quote was no better: It called for a \$500,000 deductible and a ten-fold increase in the premium.

"It's not pretty," said Jones, who ultimately settled on a policy with a \$500,000 deductible and a seven-fold premium increase.

Unlike homeowner insurance, which is tightly regulated, state departments of insurance do not regulate rates for commercial lines of insurance. When disasters strike, commercial insurance is much more vulnerable to wide swings in the market.

"The price is going up, the deductibles are going up and the coverage going down. It's a bad combination," said Guy Williams, president of Gulf Coast Bank and Trust.

It's a problem that challenges both established companies like Jones' and start-ups trying to move into the market.

Commercial real estate brokers say insurance, once a routine cost of doing business, has ballooned into a significant obstacle to property sales and development deals in which lenders often require ample coverage.

"It's gone from a minor issue in commercial property to a pretty significant issue," said Don

Schwarcz, a partner in SRSA Commercial Real Estate.

In the process, the tight market for insurance threatens to erode the effectiveness of Gulf Opportunity Zone incentives designed to spur economic development in areas hard hit by Hurricanes Katrina and Rita.

Developer Darryl Berger calls Louisiana's insurance woes the "silent killer of the recovery."

"It is a real crisis," said Ashton Ryan, who has been working on the issue as president and chief executive of First NBC Bank. "You have put a great set of incentives together for us, but if people can't get insurance, why are they going to invest? It is a critical issue for the whole recovery."

Mike Olivier, secretary of the Louisiana Department of Economic Development, says the insurance problem, in combination with rising labor costs and housing shortages, have conspired to weaken the Gulf Opportunity Zone program.

"We're having a good response, but we hoped for stronger response. One of the issues is insurance," Olivier said. "The whole purpose of the economic stimulus package was to make it more attractive to invest in the Gulf Opportunity Zone. But as other costs add up, you reduce the attractiveness of the extraordinary incentive program."

Insurance and housing now rank as "the two top issues" jeopardizing Louisiana's recovery, Olivier and other business leaders said.

Difficult market

Business and economic development leaders say the insurance crunch is yet another example of how New Orleans has become a more expensive -- and more difficult -- place to do business since Katrina.

Firms already are paying higher wages to employees, coping with steeper utility bills, and trying to operate in a smaller market.

"One of these is bad enough, but when you add all of these things together, you're going to create an environment that's extremely difficult if not impossible," said Mark Drennen, chief executive of Greater New Orleans Inc., a nonprofit business association that promotes economic development.

Extra costs make businesses less profitable and more vulnerable to downturns. They also force local businesses to raise their prices, making them less competitive than companies operating outside the Gulf South. And when businesses are insufficiently insured, local banks are put at risk because they're the ones left holding the bag if an uninsured firm is wiped out by a storm and defaults on its loans or mortgage.

As Louisiana business leaders travel to meet with prospective investors, they're increasingly questioned not about the levees, but about insurance. Investors are wary of planning a project in New Orleans if they won't be able to get insurance or if the cost is so high that it eats up the tax savings created by the GO Zone Act, Drennen, Olivier and others said.

In Rathborne's case, the cost of insurance went from about 18 cents a square foot to \$1 a square foot in a building that rents for \$3.50 a square foot. With insurance now almost one-third the cost of the space, the company has no choice but to pass the expense on to its tenants next year. Rathborne wanted to give tenants time to adjust, so it's only passing on half of the cost of the new insurance -- for now.

"We decided to eat 50 percent of those increases, just to try to keep the tenant," Jones said.

Other businesses say they won't be able to pass on the increases.

Like many business owners, Pat Garrity, president and co-owner of Garrity Printing Inc. in Elmwood, has seen his insurance premiums go from \$20,000 a year to \$70,000 a year, and he's getting less coverage.

Garrity said he won't be able to compete for jobs outside of the region if he builds the cost of insurance into his prices. "I haven't raised my prices in five years. I don't see how I can do that right now if we're going to be competitive," Garrity said. "Everyone's struggling to survive."

Business groups are working to address the problem.

GNO Inc. formed an insurance task force that met in July with political leaders in Washington, D.C., and sat down last month in New Orleans with Gulf Coast Recovery Coordinator Donald Powell.

Powell said he's not sure how much he can do because insurance is regulated at the state level, but as a former banker, he understands business concerns about insurance. "It's a serious issue," he said.

Another business group, the Coalition to Insure Louisiana, has been examining ways to improve competition among insurance companies. It intends to present a plan to Gov. Kathleen Blanco within a few weeks.

The situation has also spawned talk of creating a regional or federal catastrophe pool that would kick in after claims from a disaster reach a certain threshold, effectively limiting the risk insurance companies face and making it more palatable for them to come back into the market.

Louisiana Insurance Commissioner Jim Donelon said he thinks a national catastrophe fund modeled after the Terrorism Risk Insurance Act, which was created after the 2001 terrorist attacks wreaked havoc on the availability of commercial insurance, is the only real solution to the problem.

But until the crisis that states such as Louisiana and Florida are facing spreads to other coastal states on the Atlantic, as many believe it will, Donelon said there won't be the political will to create a national catastrophe fund.

Meanwhile, efforts to increase competitiveness among insurers in the state may take a few years to bear fruit.

"There just isn't a quick and easy solution," said John Manard, a Phelps Dunbar LLP attorney leading the GNO Inc. insurance task force.

Layering many policies

In the meantime, local insurance brokers say they have to layer multiple policies to get enough coverage for commercial clients. Those packages often include pricey high-risk policies as well as policies through the Citizens Property Insurance Corp., the state-run insurer of last resort.

"I've had many people just suggest they'd like to go bare, because they don't ever think they'll have a loss that high," said Anderson Baker, chief executive of the commercial insurance firm Gillis, Ellis & Baker, "but they have mortgages that prevent them from doing so. Often they're buying insurance that they think is worthless."

Hardest hit by the tough insurance market are commercial structures with wooden frames, such as

low-rise apartment complexes, Baker said.

Larry Schedler, president of Larry G. Schedler & Associates Inc., a commercial real estate brokerage specializing in large multifamily apartment complexes, said that insurance that used to cost \$400 a year on an individual apartment unit now costs \$1,200 to \$1,600. With increases like that, landlords must raise rents. "The rents have had to go up because the insurance has gone up dramatically," Schedler said.

Schedler said insurance is the first question that comes up when he's working with a client interested in buying an apartment complex or building a new one. Rising insurance costs may reduce profit margins or scuttle new developments. "The effects of this are far-reaching," Schedler said.

If insurance is making investing in apartments less attractive, it's a problem for the region, since housing is one of the most sorely needed components of recovery.

"Right now housing is one of the biggest challenges for our recovery. It's hard to make the numbers work," said Lee Giorgio, president of Select Properties Ltd. in Metairie.

Insurance premiums have risen 20 percent to 50 percent on Select Properties' office buildings and shopping centers but by 200 percent to 300 percent on apartment complexes.

At an apartment complex in Lafayette that was not damaged by Katrina or Rita, for example, Giorgio used to have \$24 million of insurance coverage. Now his coverage is capped at \$10 million, he's paying two to three times more for the policy, and he's got a higher deductible.

"I've got double the cost and half the coverage on the wind," Giorgio said. "You're self-insuring. Your mortgage says that you have full replacement, but if it's not available, what do you do?"

Giorgio is not alone in wondering what the banks will do.

Marty Mayer, president and chief executive of Stirling Properties Inc. in Covington, owns 12 shopping centers throughout the New Orleans area, only one of which was damaged in Katrina.

Mayer used to pay \$120,000 for a \$98 million policy with a 2 percent deductible on individual properties that were damaged, but the insurance carrier would not renew after Katrina. Mayer was able to get only one insurance quote, providing him with \$10 million of insurance coverage for a \$900,000 premium with a minimum deductible of \$500,000.

It was such a bad deal, essentially paying \$1 million a year for \$10 million of coverage, only a tenth of what was needed, that Stirling decided to pass. "We just decided not to buy that," Mayer said. "On those 12 properties, we do not have insurance at this point. We are self-insuring. Obviously, we're hoping we get through this hurricane season."

As with Giorgio, Jones and others, Mayer's insurance woes put him at odds with the banks that financed development of his properties.

"Like most people, we have loans on those properties, so we're in technical default of our loans. Our lenders understand the situation, and they don't want the properties, so they're understanding," Mayer said.

Banks in tough position

Banks are left in a tough position. Customers stuck with high deductibles may not have the cash or credit necessary to pay for the first line of damage out of pocket in a disaster, which means that the

loan is much riskier than the bank calculated when it financed 80 percent of the project.

Lenders have the right to obtain insurance on a property to protect their collateral. It's called "force placing" an insurance policy on the property. But there's only so much insurance that banks can force place.

"The banks can't look the other way. The regulators will be very upset with us," said Ryan, of First NBC Bank. "The reality is, there's going to have to be creative solutions found."

Those solutions include making people secure lines of credit or placing the amount of a deductible in an escrow account, which increases the burden that developers face in raising money for a project. Businesses can also band together to form self-insurance pools.

If banks find themselves with a portfolio of riskier loans, they risk downgrading of their corporate ratings or the ratings on the bundles of securitized loans that they sell, which affects the cost of lending money.

If banks are unable to lend money because they are unable to get adequate insurance coverage, that has implications for the availability of capital in the recovery. Regional or national banks may choose to go elsewhere to try to fulfill their lending goals, but community banks don't have that option.

"They're going to have the biggest problem," said George Green, director of commercial and multifamily lending at the Mortgage Bankers Association, which said it considers the rising cost and limited availability of commercial insurance in coastal states among its top five problems nationally.

Hesitant to take risks

Just how long commercial insurance policies will be high-priced and in short supply is the subject of debate.

Insurers tightened up after Hurricanes Audrey, Betsy and Andrew, but each time the market worked itself out.

"It lasts two, three, four years, and it comes back," said Jeff Albright, chief executive of Independent Insurance Agents and Brokers of Louisiana.

But Albright acknowledges that Katrina has cost insurers much more than they originally expected. And those losses have made them hesitant to start issuing policies -- and taking on more risk -- in the area.

A 46-page report issued late last month by the Mortgage Bankers Association concluded that the increased hurricane risk and pressure from rating agencies and reinsurers is having a powerful effect on the financing of commercial real estate.

Revised computer models have taken recent storm seasons into account and now project greater potential for damage to insurers' portfolios. As a result, the agencies that assess the financial stability of insurance companies now require them to have more money on hand to deal with catastrophes -- possibly a major hurricane and earthquake in the same year -- to maintain good ratings.

The upshot is a double-whammy for policyholders: To satisfy the rating agencies, insurers have to increase premiums to pay for their emergency reserves while simultaneously raising deductibles to reduce the amount of risk on their books.

The structural change means that insurance prices won't drop as much or as quickly as they did after previous hurricanes. "These factors seem to indicate that in the long run, prices will remain above pre-Katrina levels," though they will moderate somewhat from where they are now, Green said. "I think it's a new reality in the coastal areas."

But the situation should improve somewhat after the end of this year when the Louisiana Department of Insurance's Emergency Rule 23 expires. "Jan. 1 will be an important date in the recovery of the insurance business," Albright said.

Rule 23 is a consumer protection that has prevented insurance companies from dropping coverage on damaged homes or businesses until the end of the calendar year. Since it's virtually impossible to get a regular homeowner's policy on a severely damaged building, the idea has been to give owners more time to fix their properties or get builders risk coverage.

Rule 23's unanticipated consequence, Albright said, has been to worsen the insurance shortage. Because insurers were unable to drop derelict properties that they normally would have shed when they came up for renewal on the grounds that the risk profile had changed, their portfolios didn't loosen up enough for them to compete on other properties.

Indeed, insurance companies that offer pricey policies on property that others won't carry, known as high-risk or surplus lines, say that Rule 23 hampered them from responding to that need. Surplus carriers are usually the most nimble after a disaster, and start writing policies when regular commercial insurance companies won't.

Christopher Mills, president of the Louisiana Surplus Lines Association, said that didn't happen this time. "This has not been a typical post-storm environment."

Donelon agreed that Rule 23 "skews the market and scares the market," but the rule was a necessary evil because of the extraordinary destruction in New Orleans. "We must err on the side of the consumer while we do our regulatory job," he said.

Albright and others believe that the problem will solve itself if the market can run its course as Louisiana officials work to increase competition among insurers.

"The best way for it to happen is for the Legislature to do nothing. Don't torture the insurance companies, just let the market adjust," said Williams, of Gulf Coast Bank and Trust. "The market works when you leave it alone."

But Donelon believes it will take a national catastrophe fund to rectify the situation. Rates will come down somewhat after Jan. 1 if New Orleans survives the rest of this hurricane season, but they'll never come back to what businesses knew as "normal" without a government program to cap the risk, Donelon said.

"I don't think they'll get that low absent a federal backstop," Donelon said.

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