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Commercial insurance hits a crisis

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When Tamach Group bought a Miami-Dade County warehouse this spring, it learned the hard lesson of how South Florida commercial property insurance costs are exploding this year.

The Coral Gables-based real estate investor and developer could not get a policy from the seller's insurance company. The policy it obtained from another insurer had an annual premium four times higher than what the previous owner paid, Tamach President Manuel Huerta said.

Tamach's experience is an example of how unprecedented commercial property insurance rate increases are leading to higher operating expenses and rents.

As many property insurance bills rise by 200 percent or more, South Florida real estate, insurance and banking officials are concerned about a possible insurance-driven slowdown in commercial property sales and negative cash flow on some properties.

That danger is growing as insurance companies continue to cancel numerous policies and raise premiums on many others following last year's hurricanes, which left them battered with heavy claims in Florida and the Gulf Coast states.

The impact is being felt by thousands of South Florida commercial property owners whose policies are scheduled to renew on July 1, one of the heaviest renewal dates, but whose insurance companies have not yet confirmed they will retain coverage.

"This is an absolute circus," said Thomas Washburn, president of Pinecrest-based insurance agency Wilson, Washburn & Forster.

Many insurance companies have delayed offering renewals because they have still not negotiated contracts with companies from which they buy reinsurance, Washburn said.

That system enables insurance companies to share their claims and losses with reinsurers, many of whom are based in Bermuda or Europe. Regulators and rating agencies require insurance companies to have specific percentages of reinsurance coverage for the total amount of property they insure.

The amount of non-renewals has grown this spring because lack of reinsurance is forcing many insurers to reduce their volume of business in Florida, Washburn said.

Many of those cuts are coming in property sales, where an insurance company covered the seller, but will not take on the buyer, according to Washburn and Huerta.

Tamach's biggest hit in the wallet is at a warehouse near Miami International Airport. Tamach hoped its annual property insurance premium would remain similar to the seller's $250,000.

But Zurich International, the seller's insurance company, declined to offer a policy to Tamach, Huerta said.

That forced Tamach to shop for a new policy, which it found for a $1.1 million premium from Boston-based Aspen Specialty Insurance.

Zurich and Aspen are surplus lines insurance companies, which do not have to get rates approved by the Florida Office of Insurance Regulation (OIR). Businesses and consumers who cannot obtain policies from companies whose rates are set by the OIR are forced to turn to the surplus lines market.

The higher premium on the warehouse will increase Tamach's budget for converting the property to a condo warehouse and lead to higher prices for buyers, Huerta said.

Sellers' insurers have not renewed policies on several other properties Tamach bought this year. That forced the company to find policies from different insurers at rates two, three or four times higher than what previous owners paid, Huerta said.

"This is adding significantly to expenses, and could lead to cases where you will not be able to afford to buy a property," he said.

The cost of commercial property insurance "has become prohibitive in Florida, and for some clients it is becoming a barrier to entry," said Raul G. Valdes-Fauli, Miami-Dade president for Montgomery, Ala.-based Colonial Bank.

"A few of our borrowers are starting to look for deals outside Florida," he said. "This has been a cumulative effect from the last two years of hurricanes."

Banks are a factor in the insurance crisis because federal laws require property insurance on commercial and residential mortgages.

"Thus far, we have not found any commercial borrowers who have not been able to get insurance policies renewed or find a new company," Valdes-Fauli said. "But some are paying 250 percent or 300 percent more than several years ago. We are not seeing it yet, but it could lead to a slowdown in property sales and in the lending market."

Colonial and other banks are adding higher insurance costs to the ongoing higher costs of steel, concrete and other materials as they underwrite construction and conversion loans, Valdes-Fauli said.

Huerta said he is not aware of any South Florida developers who have lost money on projects or of any prospective buyers who have called off sales because of higher insurance costs.

But he is concerned that some investors might soon determine that "it might not make sense to buy some properties."

"In the past, insurance was really an inconsequential cost," he said. "After 9/11, we started seeing some increases. We had them after other hurricanes, but not like this year."

In South Florida's commercial market, "rental rates are not where they should be to offset spiraling costs of insurance and real estate taxes," Huerta said.

The timing of when higher costs are paid and the ability to transfer to tenants vary according to lease agreements.

A growing number of South Florida property owners are operating buildings with triple net leases, said Paul Cohen, director of the private client group in CB Richard Ellis's Miami office.

Those leases enable owners to pass increases in insurance, taxes and maintenance to tenants when leases renew.

"Some of our clients have received a moderate increase of 30 percent in insurance premiums this year, while others have seen an increase over 400 percent," said Cohen, whose client base includes Tamach.

"In the latter case, their net operating income fell below their debt service, i.e. negative cash flow," he said. "We are working with experts to resolve these problems."

CB Richard Ellis has not received any cancellations of sales contracts in South Florida because of higher insurance premiums, Cohen said.

But he feels some property owners should consider "taking a few chips off the table" and determine if they should sell some properties where future insurance rate increases could lead to income shortfalls.