SPECIAL REPORT

Marcus & Millichap

NATURAL DISASTERS AND INSURANCE RISK

October 2024

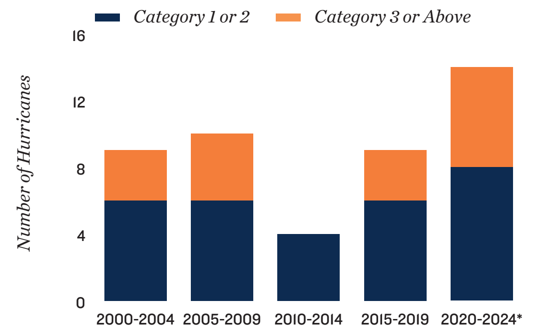
Hurricane Helene, the Latest on a Growing List of Major Environmental Events Impacting Real Estate

Weather-related risks in vulnerable areas have intensified. Hurricane Helene made landfall in Florida's Big Bend region southeast of Tallahassee in late September — about 20 miles from where Hurricane Idalia came ashore just 13 months prior. Helene, however, was a larger storm that maintained Category 4 status for a longer period of time, causing damages for a wide portion of the Southeastern United States. Nearly the entire Gulf Coast of Florida endured wind-related threats and substantial storm surge that caused water to inundate coastal communities and portions of higher-density markets like Tampa-St. Petersburg. The devastation stretched much further north after landfall, as areas in Georgia, the Carolinas, Tennessee, Kentucky and Virginia endured immense rainfall, flash flooding, landslides and tornados. Destruction of public infrastructure, including major roadways, has isolated towns within the Appalachian Mountain region. Costs are still being assessed in the wake of the storm. Moody's Analytics' initial estimate put damages in the range of $20 billion to $34 billion, but that figure could grow as more details come to light. Helene was the fifth hurricane at Category 3 status or above to hit Florida since 2017, equal to the prior two decades' total of storms that made landfall at such magnitude.

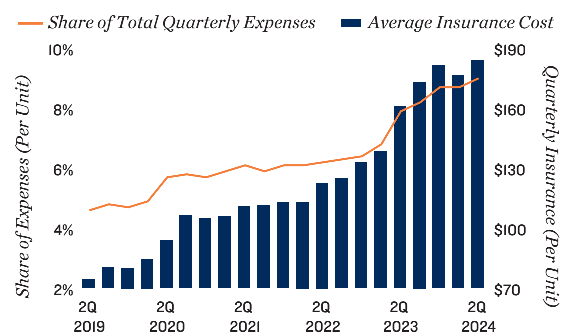
Frequency of natural disasters has several implications. The growing number and greater intensity of natural disasters in recent years has accelerated insurance costs in susceptible areas. That trend was exemplified within Florida after some insurance companies — namely Farmers Insurance — exited the state. Apartment operators have faced these implications head on. Quarterly premiums per unit surged by more than 200 percent over the past five years in Fort Lauderdale, Miami-Dade and Orlando as of June 2024. While recent lifts have been the highest in these three metros, insurance costs compose 11 percent to 16 percent of quarterly apartment expenses in all six major Florida markets, compared with a national average of about 9 percent. Insurance costs could escalate more broadly across the Southeast as providers account for the higher frequency of major natural disasters bringing impacts further inland. Those same expense pressures are affecting homeowners in the region, potentially shifting relocation preferences after robust inflows in recent years. Southeast markets made up half of the top 20 major U.S. metros for net in-migration from 2020 to 2023, but that trend may cool down, benefiting less-vulnerable locations.

Insurance costs create complications and influence investment strategies. Property valuations are being altered by historic insurance cost increases, making it more challenging to underwrite commercial real estate deals. Additionally, the upward pressure on expenses is weighing on operators' and developers' margins, potentially inducing sell-side activity and thinning construction over time. Investors with portfolios that are heavily exposed to susceptible markets may opt for greater geographic diversification to mitigate long-term risks. Insurance cost increases are not unique to the Southeast, however. Other weather events like wildfires, severe storms and flooding have had similar impacts on a wide range of locations across the country.

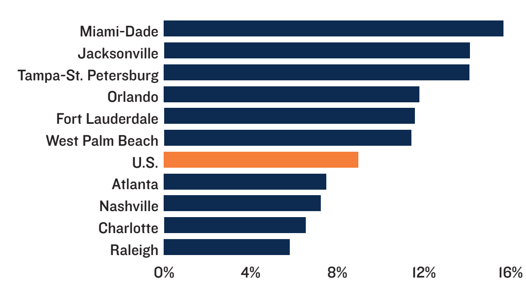
Hurricanes That Hit U.S. Mainland by Year



Insurance Elevating Apartment Expenses



Insurance Share of Expenses Highest in Florida

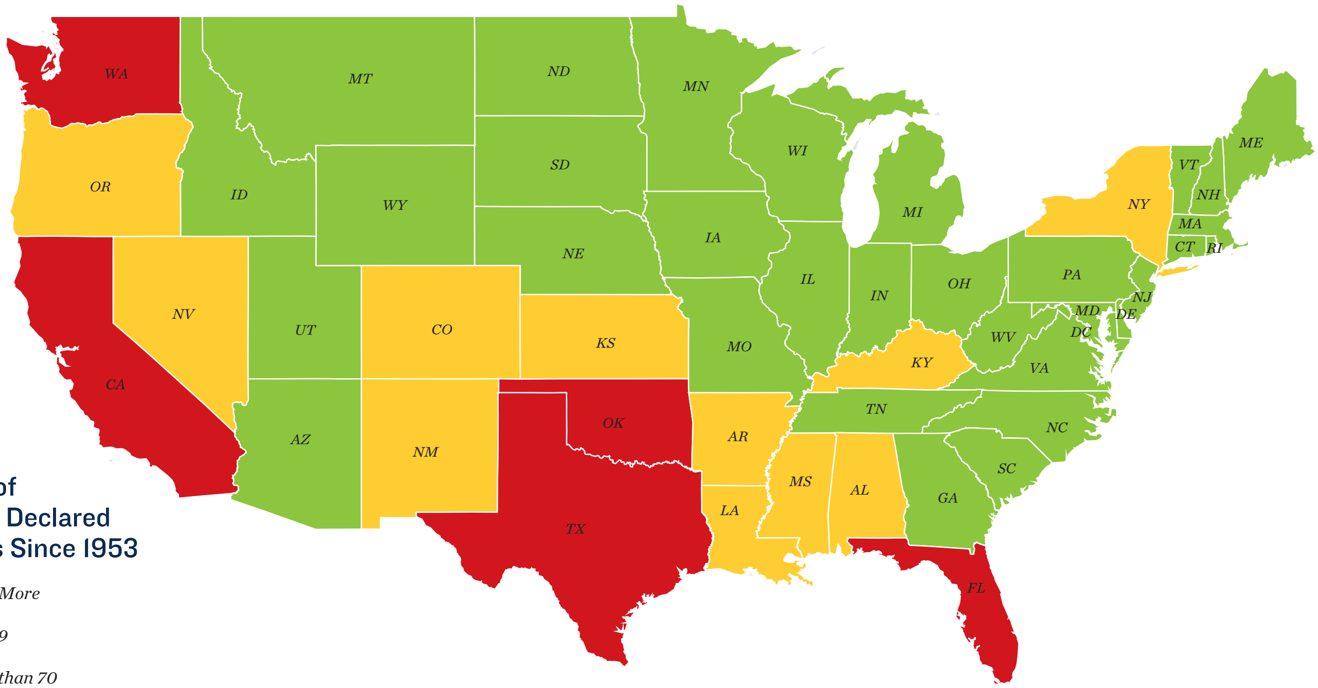


Insurance Share of Total Quarterly Apartment Expenses (2Q 2024)

* Through September

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Moody's Analytics; National Oceanic and Atmosphere Administration; RealPage, Inc.; U.S. Census Bureau

STORM'S SOUTHEAST IMPACT REFLECTS UNPREDICTABILITY AND EXPANSION OF HAZARDS



Number of Federally Declared Disasters Since 1953

100 or More

70 to 99

Fewer than 70

Note: Defined as a natural event that causes great damage and loss of life

Geographic and Asset Class Diversification May Help Investors Hedge Risk

Portfolio spread could become a more popular investment strategy. Threats from natural disasters impact many areas of the United States — from hurricanes along the Gulf of Mexico and wildfires throughout the West Coast to tornados across the Central Plains and earthquakes in tectonic regions, among other events. For this reason, no zone of the country is completely spared from the hazards that environmental forces pose; however, some locations like the Midwest, Northeast and upper Rocky Mountain regions are much less vulnerable. At the same time, many of the states' that face the most significant risks are among the most compelling for commercial real estate opportunities due to strong migration, high population density and broad economic tailwinds. This dynamic may motivate investors to include greater geographic diversification among portfolios.

Certain asset types and ownership models may gain favor. Amid an increase in environmental threats, the average quarterly insurance premium per apartment increased by almost 150 percent nationally during the five-year period ended in June 2024. Beyond just Southeastern markets, local hikes exceeded the national surge in that time in places like Orange County, Dallas-Fort Worth, Denver, Oakland, San Jose and Seattle-Tacoma — which reside in states historically among the most vulnerable to natural disasters. While home insurance rates have likewise skyrocketed in many of these locations, driving rental demand amid large affordability gaps relative to owning a house, apartment operators are facing headwinds during a span of softer rent growth. Multifamily investors that prefer to stay within familiar markets while mitigating insurance cost risk may diversify with other asset classes such as net-lease retail, office and industrial, in which tenants are responsible for insurance expenses.

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