Maximum insurance at minimum cost

By Eric Moselle, Weidner Apartment Homes

Editor's note: Over the past few days we have been collecting dozens of tips on controlling apartment expenses from investors and professional property managers. See Tips on controlling apartment expenses for more information. Although we are still collecting tips and it will be a couple of weeks before we publish our report of all of them, here is an article prepared by Eric Moselle of Weidner Apartment Homes. He shares two tips for maximizing property insurance coverage at minimum cost.

My background is in mortgage banking and in that industry, we competed fiercely for business. When I started buying insurance for a real estate investment company, to my chagrin, I learned that, contrary to what the insurance brokerage community was trying to convince me of, the insurance companies really didn’t have direct incentives to compete for my business. By insulating themselves from their customers with their intermediaries, the wholesalers and brokers, insurance companies skew competitive forces in their favor.

When we want debt financing, we approach a number of different sources of debt capital in order to ensure that competition drives the best terms. When we want to build a new apartment complex or do a major repositioning, we get bids from a number of general contractors. Our debt capital sources and general contractors do a great deal of work and put in a great deal of time preparing proposals in the hopes of winning our business without any guarantee of actually getting the business. Even when we do simple things like hiring painters or landscapers, we retain pricing power and drive pricing in our favor through competition.

When we buy insurance though, we relinquish all of our influence to drive good pricing to someone who doesn’t even work for us. Even worse, when our insurance broker goes through a wholesaler, the broker relinquishes his or her pricing power to yet another intermediary with yet another set of interests, further removing us from the insurance company.

Insurance brokers do all sorts of things to demonstrate that their interests are aligned with ours and that they are using the power we give them to get us the right insurance at the best price. However, no matter what they say, their interests are, at best, only partially aligned with ours. We can’t really know how hard they push the underwriters, even if we sit in meetings with the underwriters.
are still conversations that go on, or that don’t and should when we are not present. At the end of the day, the brokers don’t work for us. Just like our mortgage company or our general contractor, they work for themselves.

The answer to the question of how to retain pricing power is to use competition to drive the best pricing. Since insurance companies refuse to sell direct to their customers, we have to make brokers compete with one another. Such a proposal generally elicits emotional appeals to our sense of loyalty to the brokers. They want to guilt us out of a decision that is in our own interest. I have found that some brokers even refuse to do business with me under such an arrangement.

The broker’s reaction to participating in a broker competition is very telling. It baffles me that any buyer of a product or service would relinquish to a third party the ability to select the best product or service at the best price. It baffles me that the provider of a product or service would get indignant when the buyer attempts to retain his or her ability to choose for him or herself what product or service he or she wants to buy.

The broker does provide a very valuable service and that’s why the substantial fee is justified. There is no reason why insurance brokers should be guaranteed the business before they do the work to demonstrate that they are worthy of earning a fee.

By refusing to give up our power to influence pricing, we will drive down the margins that the insurance companies enjoy as well as the commissions that the brokerage community enjoys. We will also find insurance brokers that are honest and work hard for us. By doing this, we keep more of the profits we work so hard to earn and we get more value for the fees we pay to our insurance brokers.

Do the Math Before You Increase Your Retention

We’ve been in a soft insurance market for a number of years so the option to raise deductibles as a tactic to reduce premiums is not as commonly proposed as it was shortly after the turn of the decade when the insurance market was harder. Every year, I price the option to increase my deductible because I’d prefer to have more control over smaller losses.

However, I have yet to find an underwriter willing to give full value for what would be my increased retained losses. The way I calculate the value of my retained losses is quite simple. I load all my losses for each of the last five years into an Excel spreadsheet. I then calculate how much I would have come out of pocket if my deductible/retention would have been $25k, $50k, $100k, $250k,
$500k and $1M.

Since this number changes substantially from year to year, I calculate the average over the last 5 years at each retention level and what my retention would be at one standard deviation in either direction off the average. From this, I can get a general sense of how much my retained losses would increase if I set a higher retention. Once I know how my retained losses would change given different retentions, I can know how much my premiums should go down given a corresponding increase in retention.

Once we return to a hard market, it will be interesting to see if underwriters will begin giving appropriate reductions in premium for increased retention. In either a hard or a soft market, it is valuable to understand whether higher deductibles actually reduce total expenses.

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