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Trends in the Marketplace: Property Insurance

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Construction Cost Inflation

- According to CoreLogic:
  - Lumber prices down
  - Drywall, concrete block, shingles continue to rise
- According to SageSure:
  - Still an inflation coverage gap of up to 8% (not unique to FL)

Lack of Competition in Private Market - Florida

- Still very few insurers willing to quote in many areas of Florida
- New company formation occurring (5+)
- Depop starting: Edison, Florida Peninsula, Homeowners Choice, Loggerhead, Monarch, SafePoint, Slide
- But Citizens not really shrinking yet
- Private market still fragile
  - Losses narrowed, but not profitable

Lack of Competition in Private Market

- Not unique to FL
  - LA, CA
- Is California “Florida circa 2007/2008?”
- Regulators had an advantage in large states for many years:
  - Market size ensured insurers would stay
  - Risk/reward trade-off is not there for insurers

Availability/Affordability Issues

- According to NY Times (& Policygenius):
  - Florida had highest increases – 35%
  - 15 states had increases above 20%
  - All states were above 10%
- According to First Street Foundation
  - NFIP doubled rates in 12 states
  - 21% drop from highest levels of market penetration for NFIP policies

Availability/Affordability Issues

- If I want to live in paradise, I need to be able to afford it
  – I can't afford to live in Monaco, I can't afford to drive a Bugatti.
  – Problem: What if I have gotten used to living in Monaco and driving a Bugatti?
- What if Florida is only available to the wealthy?
  – What happens to growth?
  – What happens to economic development?
  – How do wealthy obtain products/services?

Climate change jumping in on insurance

– First Street Foundation – 9th National Risk Assessment
  - 640K mortgages in US in delinquent status and rising insurance costs increase the likelihood of default
  - Approx. 20K structures per year destroyed by wildfire
  - Climate-adjusted insurance pricing just arriving
  - Climate-bubble in housing market

Relationship between insurance costs and mortgage default

- 640K mortgages in US in delinquent status and rising insurance costs increase the likelihood of default
  - empirical evidence that insurance costs lead to higher default rates?
  - empirical evidence that natural disaster events leads to higher default rates?
  - If this is true:
    - Differential mortgage rates depending on hazard risk
    - This could be really bad news for FL, and many coastal states
  - As more of the costs of disasters are borne by the individual homeowners (higher deductibles, higher rates) this becomes more likely

Increasing wildfire risk

- Interesting because it is:
  - Covered by HO policy
  - Expanding regional exposures
  - Subject to peril-specific risk models
  - Subject to regulatory responses similar to hurricane exposure 15 years ago

Climate-adjusted insurance pricing

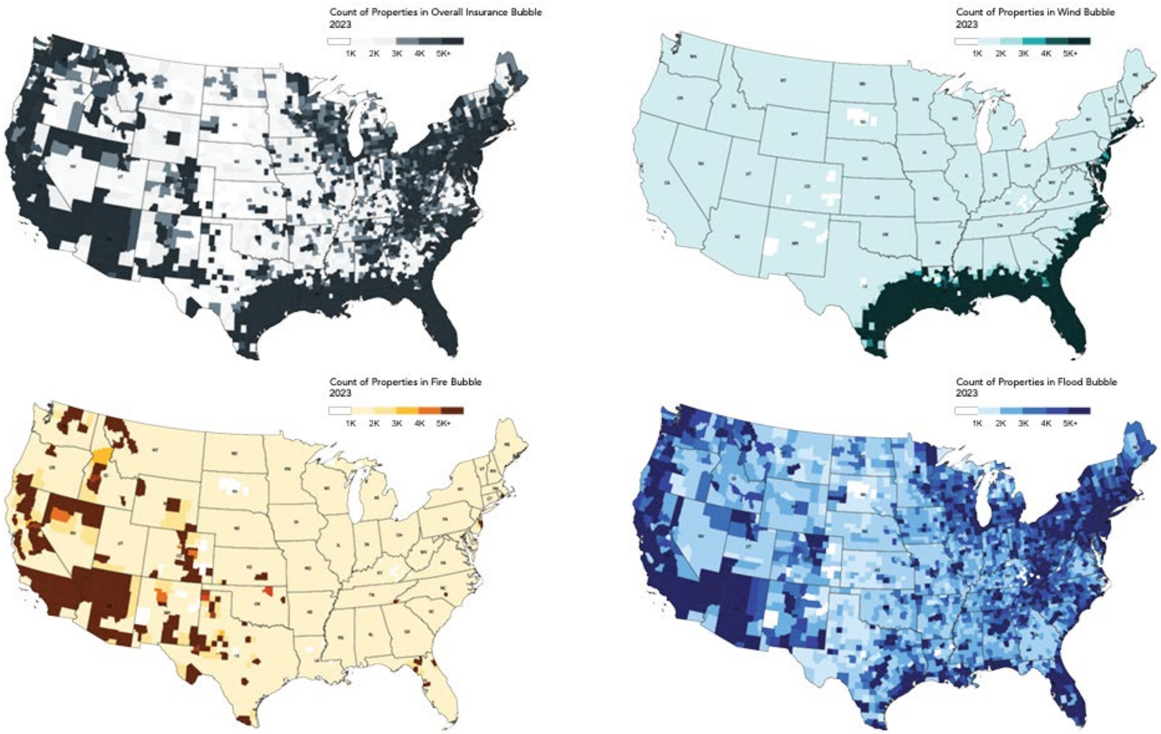
- What is climate-adjusted insurance pricing?
  - Climate change is long term
  - Insurance pricing is not (at least in the private market)
  - Need evidence of actual change in short-term risk to adjust price
  - For windstorm/wildfire => models need to incorporate climate change into frequency and/or severity of events to be in pricing
  - How accurate can you transform long term changes into short term frequency/severity?
  - Increases in uncertainty => higher risk charges

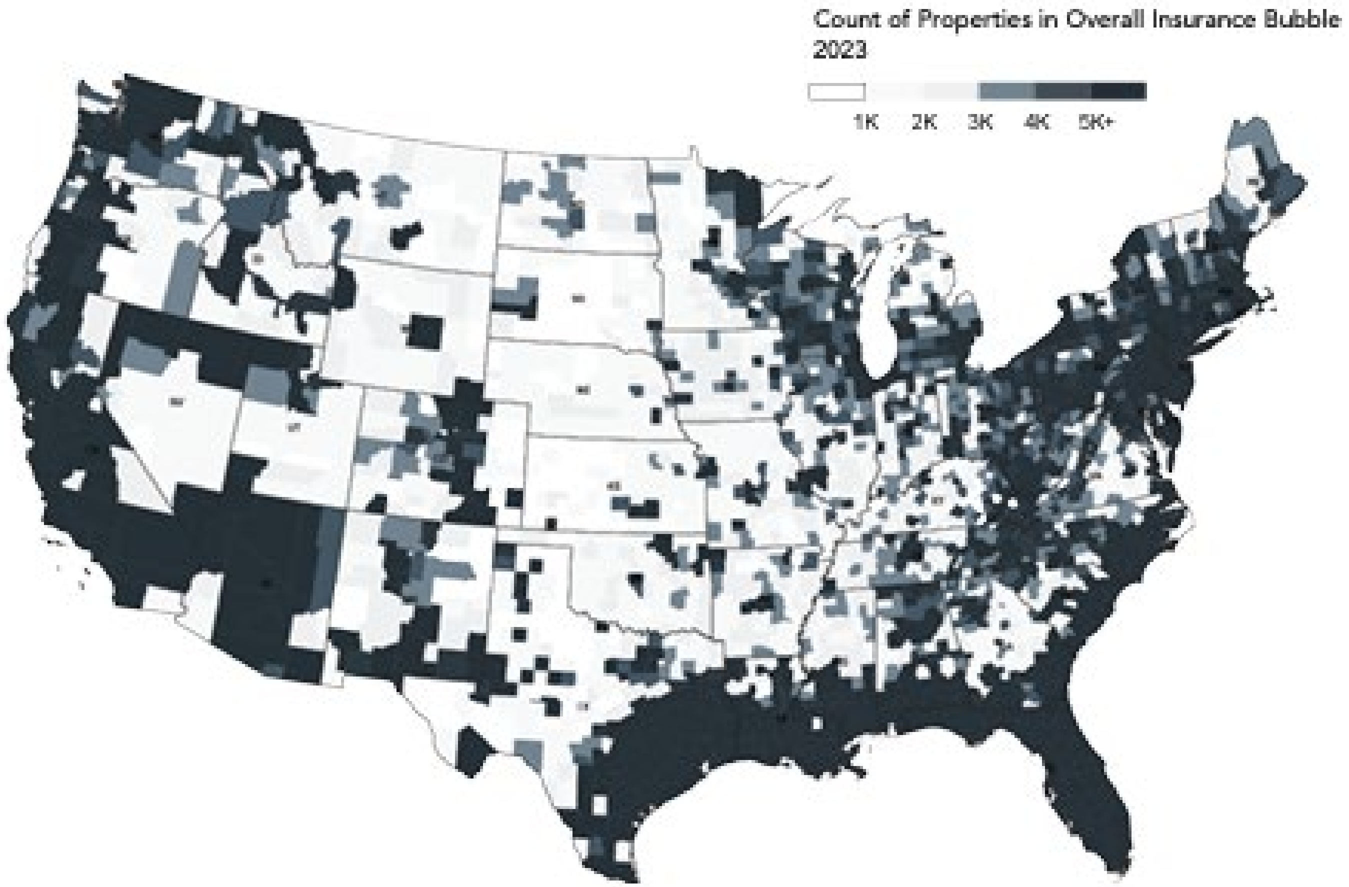
Climate Bubble in Housing

- Predicting a 40% drop in property values in FL
- This was my dissertation way back in the 90's
  - Into Harms Way: Insurance Premiums and Housing Values
- Real Estate Theory:
  - Housing stock is fixed short term, completely elastic long term
  - Changes in cost should lower demand and should have an immediate impact on housing prices
  - Long term, it will impact how many houses there are, but prices will return to whatever construction costs dictate

Geographic Insurance Bubble

It's Not Just Wildfire - Pressure on Flood and Wind Insurance is Increasing Too




Count of Properties in Overall Insurance Bubble
2023
1K
2K
3K
4K
5K+

Climate Bubble in Housing

- In reality, real estate prices are sticky, it takes time for costs to have an impact (rising mortgage rates, rising construction costs, demand and prices still have not waned as much as predicted)
- Long-term changes are really long term. Look at Detroit and other major cities how long it takes real estate to adjust to demand changes.

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Long Term Trends in Property Insurance

Remember, I am wrong often

The Private Market HO Insurance Value Proposition

- Underwriting Expertise
  - Risk Pooling
    - Reduced, less cross state “pooling”
  - Risk Identification – Pricing of Risk (cat models)
    - Little variation across insurers
- Capital to Support Potential Losses
    - Reduced, smaller companies, less capital to support primary layer
    - Bigger reliance on reinsurance in higher layers
    - When opportunity was there to accumulate capital, failed to do so

Where do we go from here?

- Darned if you do and darned if you don’t
  - Any significant market interventions are going to have far-reaching effects
  - Doing nothing will have far-reaching effects
- What are the economic/political consequences of a dysfunctional private property insurance market?

How many times have we had to have government intervention?

- In insurance?
  - Citizens, Cat Fund, CEA, NFIP, Crop, TRIA
- In finance?
  - Lehman Bros. vs. Bank of America/Citigroup, AIG, GM
  - Fannie Mae/Freddie Mac
  - S&L Crisis in the 80s/90s
- What would have happened if the gov’t didn’t step in?

What (our) private property insurers are not good at:

- Spreading risk through time
  - Cannot collect money this year for losses that happened in the past
    - competition from new entrants will prevent that
  - Cannot reserve for events that will not occur during the coverage period
- Providing price & availability stability
  - Managing reinsurance market volatility
  - Managing cost of capital volatility
  - Exposes consumers to fluctuating pricing (think gas prices)

Are there interventions that can work?

Put on your thinking caps!

Intervention Possibility #1

- Incentivize new company formation
  - Assumes that the problems that forced insolvencies have been fixed
  - Assumes there is capital interested
  - Assumes they can do better than the last group of domestics
  - Looks to me to be a short-term solution to a long-term problem
  - Think of it from a return-on-investment problem
    - How do you incentivize investment?
    - What is an “adequate” rate of return?
    - How do you incentivize not just initial investment, but also capital growth?

Intervention Possibility #2

- Remove the largest externality from the private market
  - Public entity takes all the wind risk, flood, wildfire, etc…
    - Adds stability to the private property insurance market
    - Acts as a clearinghouse for reinsurance/alternative risk transfer market
    - Improves efficiency in negotiation
    - Greatly increases political risk (see NFIP, SS, Medicare)
    - Greatly increases financial risk to the public entity

Intervention Possibility #3

- Public/Private Partnership
  - Theory: finance the entire loss distribution minimizing the overall cost of capital
    - Participants: Property owner, insurer, reinsurer, gov't entity
    - Property owner must be able to afford expected loss, can we minimize the cost over and above that to finance the volatility of potential losses?

Intervention Possibility #3

- Public/Private Partnership
  - Historically government intervention in markets has shown that they cannot identify risk and price risk very well.
  - Allow private market insurers to underwrite and charge differential prices at lower end of the loss distribution
  - Government/public entity market entry occurs at higher levels of loss distribution (e.g. 1-in-50 year, 1-in-100 year event
  - Government is better at raising capital when necessary

Intervention Possibility #3

- Public/Private Partnership
  - Gov't is better at spreading risk through time
  - Can regulate prices better
  - Shouldn't be involved first dollar, but at some point losses are high enough that government intervention may be warranted

Think Big Picture: How do we get out of this?

- Reduce future storm losses
- Smarter future growth
- Understand that any (non)intervention is going to have far-reaching effects