



Climate Change and the US Homeowners' Insurance Market

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Climate Change Demands Federal Action in the U.S. Homeowners' Insurance Market

In recent years, the physical impacts of climate change have been accelerating across a range of industries, from agriculture, to manufacturing, to property insurance. Through their adverse effects on production, capital structures, and property markets, the physical impacts of climate change have been imposing significant costs on the public, the business sector, and the nation's economy.

One particular area of concern is the homeowners' insurance market. Climate change has led to a drastic increase in cost and decrease in availability of homeowners' insurance that must be addressed by policymakers at the federal level. Without intervention, rising insured and uninsured losses threaten housing market stability and broader economic growth.

The Crisis of Climate-Driven Home Insurance Losses

As climate change-driven weather extremes and natural disasters have been **intensifying** in their frequency and severity, they have been inflicting increasingly more damage and destruction to U.S. residential properties, leading to **soaring numbers of claims and rapidly rising payouts for insured losses** in the U.S. homeowners' insurance industry. In response, **home insurers** have been **raising premiums, applying greater deductibles, reducing coverage, and exiting high-risk geographic areas**.

Amidst the **recent trends** of rising homeowners' insurance premiums, falling insurance coverage, and declining availability of homeowners' insurance, a growing number of U.S. homeowners have been struggling to protect themselves against financial losses due to property damage or destruction. Because insurance coverage has been shrinking, even those with homeowners' insurance have been finding it more challenging to cope with the financial impacts of property damage or destruction due to weather extremes or natural disasters. Further, as home insurers have been exiting high-risk geographic areas, a growing number of U.S. residential properties have become **uninsurable**.

The rapid rise in homeowners' insurance premiums and growing insurer exits from high-risk geographic markets have been worsening the **housing affordability** crisis in the U.S. Since mortgage lenders require homeowners' insurance as a pre-condition of **mortgage financing**, rising homeowners' insurance premiums and falling insurance availability have made it more challenging for the prospective homebuyers to purchase a home. Meanwhile, the rise in homeowners' insurance premiums has been increasing the cost of homeownership for the existing homeowners. In addition to soaring premiums, the existing homeowners have been faced with higher out-of-pocket expenses due to property damage or destruction, as insurance

coverage has been shrinking.

Falling home insurance protection is projected to increase homeowner reliance on loans and credit cards as a means of financing growing out-of-pocket expenses related to property damage or destruction. At the same time, rising homeowners' insurance premiums are expected to **increase homeowner reliance on credit as a means of financing regular household expenses**. The adverse financial impacts of falling homeowners' insurance protection and rising premiums further include growing credit card delinquencies, rising cost of credit, and higher mortgage defaults, among others, with disproportionate impacts on low-income and minority households. These and other adverse financial impacts can have broader economic spillover effects **with further repercussions for the U.S. financial system stability**.

Recommendations to Address the Home Insurance Affordability Crisis

Given the current crisis of homeowners' insurance affordability and availability and its implications for the U.S. financial system stability, public policy intervention into the homeowners' insurance market is critical. **Public policy intervention must be aimed at stabilizing the homeowners' insurance market and increasing the availability and affordability of quality homeowners' insurance coverage**. The following recommendations seek to address these aims:

- **Means-tested or income-based home insurance premium subsidies.**
- **Increased public investments in climate change adaptation and mitigation.** Investing in climate change adaptation and **mitigation measures could reduce climate-driven residential property damage and destruction**, thereby lowering insured losses for the homeowners' insurance industry. Such adaptation and mitigation measures include infrastructural improvements aimed at **expanding flood and wildfire defenses** and reducing the severity of extreme weather impacts; **greater reliance on renewable energy sources; reforestation; and coastal restoration, among others**.
- **Public-private investments into residential dwelling.** According to the **Deloitte Center for Financial Services analysis**, if home insurers partnered with government agencies and invested \$3.35 billion in residential dwelling resilience measures, such as impact-resistant glass windows, reinforced doors, and enhanced roof coverings, among others, then the two-thirds of U.S. homes that are currently not built to code could be made resistant enough to withstand more weather extremes. Greater home resilience would help reduce many weather-related claims losses for the homeowners' insurance industry, saving the insurers as much as \$37 billion, and moderating the rise in homeowners' insurance premiums.
- **Public-private risk sharing programs.** In areas where private insurers remain active, the federal government could act as a reinsurer for residential property losses from weather extremes and natural disasters. The federal government should charge premiums to private insurers, and pay out claims when insured losses exceed a certain amount. Such **public-private risk sharing programs** could help stabilize the homeowners' insurance industry and expand the affordability and availability of homeowners' insurance coverage.
- **Federal government selling insurance coverage directly.** In markets where private insurers have exited entirely or coverage is no longer available at any price, **the federal government should bear all of the**

risks for certain natural disasters, such as wildfires and hurricanes, and sell insurance coverage directly to homeowners. The federal government would set the premiums and the terms of coverage, similar to the way the National Flood Insurance Program (NFIP) currently does for flooding. A universal federal insurance program where the federal government bears the risks from all the natural disasters could be considered as well.

Climate change has been a key factor behind the recent trends of rising homeowners' insurance premiums, shrinking homeowners' insurance coverage, and declining availability of homeowners' insurance. The current crisis of homeowners' insurance affordability and availability necessitates federal government intervention into the homeowners' insurance market aimed at improving the affordability and availability of homeowners' insurance policies.