

# The Insurance Perspective: Setting the Stage

**Charles Nyce, PhD**

**Exploring Impediments to a Real Estate  
Recovery: A Policy Discussion**

**Federal Reserve Bank of Atlanta**

**Center for Real Estate Analytics**



THE FLORIDA STATE UNIVERSITY  
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*The Florida Catastrophic Storm Risk Management Center*

# Property Insurance 101 – Property Owners

- Flood – generally not covered (NFIP, excess flood policies)
- Wind – covered by standard HO policies (some cases separate coverage: wind and ex-wind policies)
- For SE US: main risk is windstorm, wind vs. water a big issue in many coastal areas
- Fannie Mae requires replacement cost insurance coverage from rated insurer (or residual market coverage)

# Property Insurance 101 – Property Developers

- **Builder's Risk Policies –**
  - covers same basic perils as property insurance policies, just for the period of construction
  - Property under construction faces different risks than those already completed
  - Considered a commercial line of coverage
    - Sold by different insurers
    - Less regulated than personal lines policies (HO, Auto)
    - Access to coverage vital to real estate development

# Setting the Stage

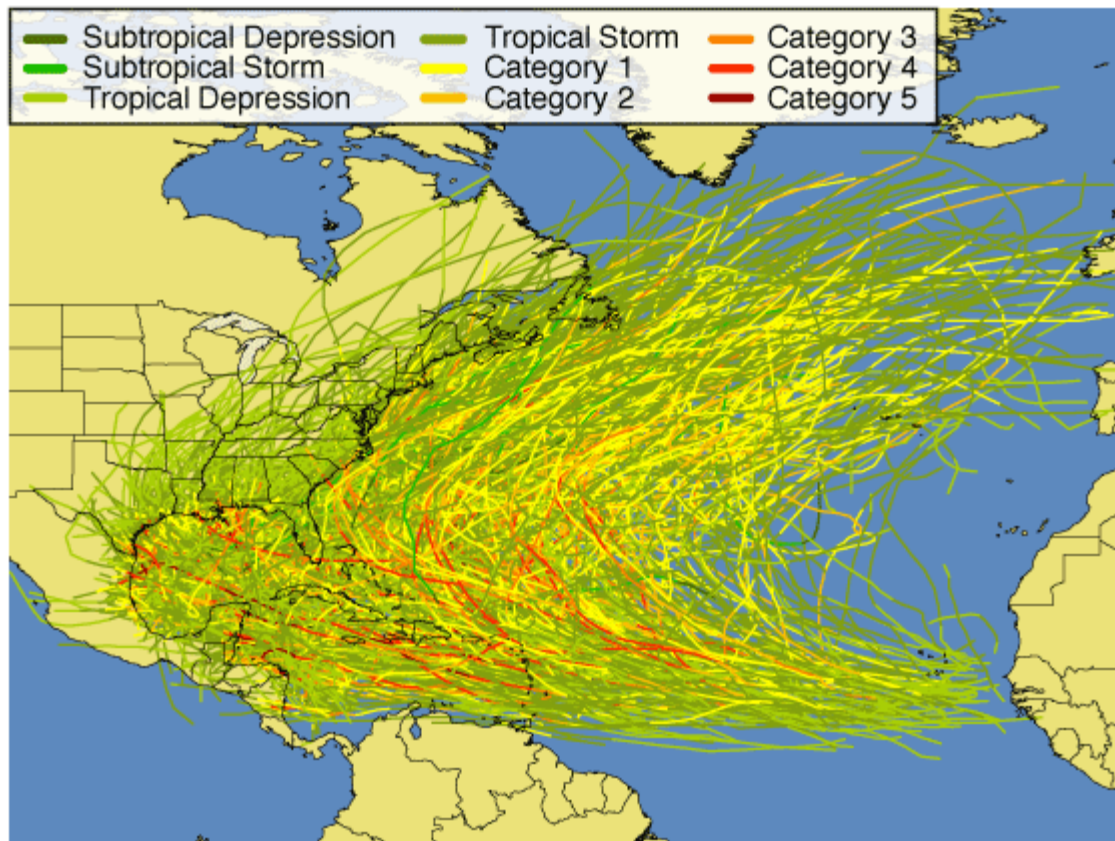
1. What role (if any) does property insurance play in real estate values or real estate development?
2. What has happened in property insurance markets relevant to real estate?
3. Will property insurance have a role in a real estate market recovery?
4. Will property insurance have a role in more general economic recovery?

# What role (if any) does property insurance play in real estate values or real estate development?

- **Natural Hazard Risk & Housing Values**
  - Harrison, Smersh, & Schwartz (2001); Dei-Tutu (2002); Shilling, Benjamin, & Sirmans (1989)
- **HO Insurance Premiums and Housing Values**
  - Nyce (1999); Dumm, Nyce, Sirmans, & Smersh (2011)

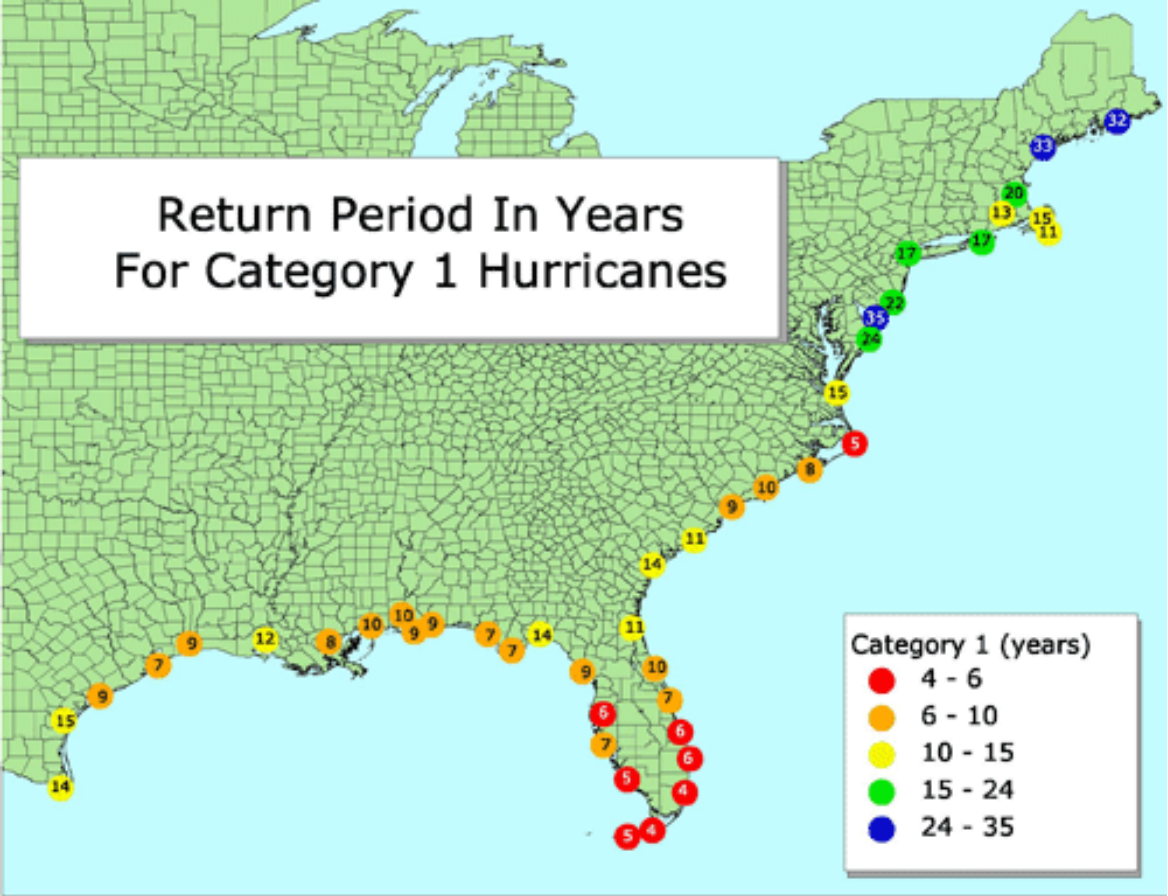
What has happened in property insurance markets relevant to real estate?

**“We Don’t Have an Insurance Problem, We Have a Hurricane Problem”**



Source: USGS

# “When does low frequency become too frequent?”



Source: NOAA

# Role of Insr Premiums

- Insr Premium serves as a risk signal: Objective pricing of risk
  - Especially important for LF/HS events (human behavior literature)
- Annual, recurring cost of property ownership – capitalized into housing price (same as taxes)
- Concerned about role of property insurance in real estate recovery, should be concerned about ignoring objective pricing of risk in recovery – long term implications



# How Did We Get Here?

## Confluence of Events

- Game Changers (Andrew, Katrina, Ike, 04/05 seasons in FL)
- Coastal Exposure Growth
- Technological Advances (Cat Models)
- Insurer Exposure Management
- Regulatory/Legislative Actions
  - Residual Market Growth

# Changes in Private HO Market

1985-2010	Total Decision Centers	Groups	Ind. Cos.	Total PHS	Group PHS	Ind. Cos. PHS	Total DPW	Group DPW	Ind. Cos. DPW
Nat'l	-19.40%	-27.27%	-9.78%	431.80%	429.60%	536.14%	364.74%	354.95%	628.60%
AL	-34.18%	-34.25%	-33.33%	300.75%	298.65%	1613.27%	420.60%	421.38%	227.04%
FL	-37.80%	-46.15%	0.00%	145.54%	144.41%	338.60%	849.12%	638.04%	6462.47%
GA	-35.58%	-37.63%	-18.18%	364.18%	362.45%	1110.49%	473.17%	486.44%	83.60%
LA	-46.99%	-53.33%	12.50%	283.14%	281.53%	1282.99%	357.19%	323.81%	1092.75%
MS	-38.03%	-39.39%	-20.00%	306.98%	304.58%	2160.90%	405.20%	430.07%	-86.12%
NC	-31.87%	-41.98%	50.00%	425.35%	424.64%	591.78%	500.20%	502.51%	408.59%
SC	-24.44%	-29.27%	25.00%	275.23%	272.95%	1125.98%	509.62%	503.54%	767.25%
TX	-40.00%	-44.90%	-11.76%	154.61%	152.11%	1579.91%	381.37%	369.22%	1097.66%
VA	-36.63%	-39.13%	-11.11%	331.74%	329.85%	927.39%	500.24%	493.79%	4081.72%

# Growth in Public Insurance Providers

State	Premiums Written (000's)	Premiums Earned (000's)	Exposure (000,000's)
Alabama	\$37,769	\$15,006	
Florida	\$2,604,265	\$1,971,649	\$508,520
Louisiana	\$209,946	\$154,738	\$26,675
Mississippi	\$79,082		\$7,024
North Carolina	\$ 303,258	\$302,197	\$68,000
South Carolina	\$97,127	\$12,099	\$14,493
Texas	\$304,393		\$76,971

# Residual Markets

- Historically used to address availability problems
- Many charge rates higher than private insurers
- Generally rely on some post-loss financing of risk that is spread over a significant portion of the state's population
- Can be more exposed to political risk

# Market Changes in Insurance

- Smaller insurers, less diverse, more reliant on reinsurance
- Significant growth in residual markets with reliance on post-loss funding (often equivalent to a tax)
- More sophisticated loss modeling (early in the process)
- Anecdotal evidence of more property owners “going bare”

# Setting the Stage

1. Will property insurance have a role in a real estate market recovery?
2. Will property insurance have a role in more general economic recovery?
3. What happens if we ignore objective pricing of risk?
4. What systemic risks are involved in property insurance markets that are not properly functioning?

# Questions?

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