ENVIRONMENTAL LAW INSTITUTE WEBINAR

The Coastal Property Insurance Crisis: Policy Options in a Time of More Severe Storms and Rising Seas

READ AHEAD PAPER
Webinar Date: March 13, 2024; 12:00 ET

This *Read Ahead* paper provides background information for the Environmental Law Institute (ELI) webinar, *Policy Options for Strengthening the U.S. Coastal Property Insurance System,* on March 13 at 12 noon ET.

I. Introduction: The Coastal Property Insurance Crisis

More severe storms and rising sea levels along the coast of the United States pose a threat to coastal communities, including millions of homes and businesses. Insurance helps coastal property owners manage financial risks associated with storms and flooding, and provides the financial sector with confidence that mortgages and other financial investments are secure.

For property along the coast, insurance comes in two forms. The National Flood Insurance Program (NFIP) provides most of the insurance for traditional storm-driven coastal flood risk and is required by federally insured mortgages. Flood insurance through the federally sponsored NFIP is generally available, although the maximum loss payment for residential property is only $250,000 (a fraction of the value of many coastal homes) and premiums are steadily increasing.

Private insurance companies provide more general property insurance covering storm damages other than conventional flooding. These policies offer a degree of financial security to coastal homeowners and stability to the property financial system. Unfortunately, as climate change drives more frequent and intense coastal storms, insured damages to coastal property are steadily increasing. In addition, projected sea level rise will push storms and disaster-related property damage to wider areas farther inland.

Anticipating sharp increases in damage claims from coastal policyholders, private insurance companies have stopped serving some coastal states or have dramatically increased rates. In response to increased risks and increased insurance prices, some owners are selling properties or foregoing insurance when not required by a mortgage.

These trends pose risks to the financial health and security of homeowners and to the economy more generally:

- Very high-cost insurance, or the risks imposed by no insurance, will gradually reduce the value of coastal homes that are the principal financial asset of many homeowners, and lead to increasing mortgage default rates.
- Mortgage defaults can be financially crippling for homeowners and rising default rates threaten financial institutions, including federal institutions that guarantee mortgages.
- Low-income homeowners are the least able to absorb premium increases and least able to able to manage a sale and relocation.
- Declining coastal property values also threaten to lower municipal tax revenues and the capacity to repay municipal bonds.
- Lag times between increasing risks and corresponding premium increases will result in some properties lacking insurance sufficient to protect mortgage holders, posing a risk to financial institutions, including federal mortgage institutions.

Taken together, the consequences of declining availability and increasing costs constitute a coastal property insurance crisis.

This webinar will include a panel of experts focusing on two key questions related to the coastal property insurance crisis:

- what should be the national goals for operation of the private coastal property insurance market (i.e., property insurance rather than flood insurance under the National Flood Insurance Program)?, and

- what national programs and policies might insurance providers and governments adopt to best guide the coastal property insurance market toward desired national goals?

This *Read Ahead* paper provides background information on the coastal property insurance crisis, including the following topics:

- overview of risks to coastal property from more severe storms and rising sea levels;
- review of recent increases in coastal property insurance cost and declines in availability;
- description of the consequences of coastal property insurance changes for owners, insurance companies, and government, including macroprudential risk to the coastal property financial system and broader U.S. economy;
- outline of a preliminary set of goals for the coastal property insurance market for discussion purposes (i.e., what are the attributes of a private coastal property insurance market that is in the best interest of the country?); and
- suggestions for potential government policies and measures to move the existing coastal property insurance market closer to meeting desired goals.

II. Storm and Sea Level Rise Risks to Coastal Communities

Climate change poses a significant risk to coastal communities through the impacts of more severe and more frequent storms bringing temporary flooding and widespread damage. As sea levels rise, storm impact areas will expand, and coastal areas will increasingly see permanent inundation unrelated to storms. These storms and rising seas bring flood waters to homes and businesses, but also threaten coastal ecosystems (e.g., beaches and wetlands) and major, critical infrastructure assets that provide essential services such as transportation, energy, and water. The multiple dimensions of these coastal impacts will gradually reduce property values, undermine the financial condition of property owners and communities, and diminish the capacity to recover from major storm events.

Coastal Storms: Coastal storms are a major risk to life and property, and major storms can deliver storm surges of over fifteen feet. A warming climate is causing an increase in the number of the strongest storms, which bring more extensive coastal flooding, higher storm surges, and increased rainfall. Research indicates that the speed of intense storms is slowing down and storms are thus lingering and raining on a given place for longer, generating even more flooding. Even as storms move more slowly, they intensify more rapidly, making their landfall harder to predict and more likely to result in major damage and loss of life.

The National Oceanic and Atmospheric Administration (NOAA) reports that disasters with impacts of over a billion dollars have increased since 1980. Of all these billion-dollar events, including wildfire, droughts, and floods, coastal hurricanes were the single biggest contributor to damages, accounting for 54 percent of all costs for a total cost of over $1.3 trillion. Hurricanes were also the single largest cause of deaths, accounting for over 40 percent of all deaths (i.e., 6,890 total deaths from 1980 to 2022, about 160 per year).

Sea Level Rise: NOAA recently issued new estimates of future sea level rise, concluding that sea level along the U.S. coasts is likely to rise as much over the next 30 years (i.e., about 1.3 feet by 2050 in the "Intermediate" scenario) as it has over the last 100 years. Sea level rise averaging as high as 1.7 feet around the coastline is possible over this period, and could reach as high as 2.2 feet in some places (e.g., the Western Gulf of Mexico).

By the year 2100, NOAA projects that sea level rise along the U.S. coasts will average about 4 feet in the "Intermediate" scenario, while an average increase of over 7.2 feet is possible. Sea level rise in some regions could be higher. By 2150, NOAA forecasts average sea level rise of over 7 feet in the "Intermediate" scenario and the possibility of average increases as high as 12.8 feet, with increases in the Western Gulf of Mexico of 14.7 feet.

Impacts of More Severe Storms and Rising Seas: More severe storms and rising seas will bring economic, environmental, and social disruption to coastal communities on an unprecedented scale. In the short term, coastal communities can expect more "sunny day flooding" during high tides and larger surges and greater flooding during storms. In the longer term, all or parts of hundreds of coastal communities will face far more extensive flooding than they currently experience. As sea levels rise, sunny day flooding will increase and gradually lead to permanent inundation. The combination of more severe storms and rising seas is projected to result in potential losses of coastal property running into trillions of dollars.

These loss estimates, however, are based on the existing population along the coast, and are likely to rise further as new development occurs in risky coastal places in response to population increases. Today, the coastal counties along the U.S. coasts are home to over 100 million Americans. The population living right along the coast (i.e., places at elevations of 33 feet and lower) is expected to double by 2060 to about 44 million people.

Finally, it is important to note that many low-income and disadvantaged communities are among those in harm's way. These communities are disproportionately affected by climate change including sea level rise and extreme coastal weather events, and often lack the resources to respond to these risks.

III. Shortfalls of the Coastal Property Insurance Market

Private property insurance companies, and the reinsurance industry that supports them, are experiencing cost increases associated with coastal property, and many recognize that more severe storms and rising seas will drive these costs significantly higher in future years. With these risks in mind, property insurers are increasing premiums, reducing coverage, or declining to offer renewed or new property insurance policies in some areas they deem risky.

> "It's not hyperbole to say that the United States may very well be on the brink of a homeowners insurance crisis, at least in its coastal areas."
>
> *States May Need to Scramble to Address Possible Homeowners Insurance Crisis*; LexisNexis; July 2023

Changes to the Coastal Property Insurance Market: Some of the recent changes to the coastal property insurance market include:

- **California:** State Farm and Allstate have stopped selling property insurance to new customers.
- **Florida:** Farmers announced it will no longer offer any new property coverage in the state of Florida, and American International Group (AIG) said it will no longer insure houses along the Florida coastline. As a result, homeowners insurance rates in the state are four times the national average.
- **Louisiana:** A fifth of homeowners insurance policyholders in Louisiana have had their provider cancel their policy, according to a 2023 survey by LSU.
- **Texas:** Many small insurance companies have become insolvent, and thousands of property owners have shifted to a state-run insurance program.
- **North Carolina:** North Carolina's top insurance regulator recently denied an industry request to raise homeowners' insurance premiums by an average of 42% — and to almost double them in parts of coastal counties.

- **South Carolina:** An assessment of the coastal property market found that home insurance rates have increased significantly due to the frequency of these natural disasters.

Where coastal property insurance is still available, it has increased in price. Lexis/Nexis reported that the cost of property insurance has increased an average of 21 percent since 2015. Prices increased in every state except Alaska, with prices increasing over 30 percent in eight states and over 50 percent in Florida.

As private insurance companies increase prices, reduce coverage, or decline to offer new policies, states have stepped in to provide insurance as an insurer of "last resort." For example, state programs are operating in Florida, Louisiana, and California.

In response to these and other changes in the property insurance market, Senator Sheldon Whitehouse, Chair of the Senate Budget Committee, sent letters to 41 companies in early November 2023 as part of a larger investigation of climate change and insurance challenges. In addition to concerns about insurance price and availability, the letter noted:

> A widescale decline in coastal and wildland-urban interface (WUI) community property values would present a systemic risk to the U.S. economy, similar to what occurred in the 2007-2008 mortgage meltdown.

In a related action, Whitehouse sent a letter to the State of Florida-managed property insurance program seeking information about its operations and the potential need for a bailout by federal taxpayers.

The adjustments that property insurance companies are making now are likely to continue. One source of future rate increases is the cost of reinsurance. A new model for North Atlantic hurricanes developed by Moody's RMS is expected to increase costs by 10 to 30 percent starting in 2023.

Although climate change is commonly cited as a cause of property insurance rate increases, other factors thought to contribute to increases include inflation, especially with respect to construction and reconstruction costs, costly litigation, and alleged fraud.

Impacts of Coastal Property Insurance Market Shortfalls: Increased insurance premiums pose financial hardships for homeowners, especially low-income homeowners, and in some cases can lead to devastating impacts related to a mortgage default or financial risks associated with going uninsured.

In addition to having impacts on individual homeowners, changes in the coastal property insurance market are driving a series of changes in the wider economy:

1. **Coastal Property Value Decline:** Although changes in the value of coastal property are variable based on many factors, there is some evidence that the value of property in risky coastal areas is declining and that the declines will accelerate. One factor in this decline is the increasing cost of both property and flood insurance.

2. **Decline in Local Property Tax Revenues:** Coastal property is often high-value, generating significant property tax revenues for local governments, and declines in coastal property value will reduce revenues for local governments.

3. **Municipal Bond Rate Increases:** The decline in property values, partially due to increasing property insurance costs, is expected to increase the costs of borrowing for local governments. The BlackRock investment company concluded:

    > Extreme weather events pose growing risks for the creditworthiness of state and local issuers in the $3.8 trillion U.S. municipal bond market.

    A 2018 study found that:

    > Counties more likely to be affected by climate change pay more in underwriting fees and initial yields to issue long-term municipal bonds compared to counties unlikely to be affected by climate change.

4. **Shift of Mortgages from Private Sector to Government:** As lenders recognize the risks to some coastal properties, they can reduce their risk by securitizing loans for federal institutions such as Freddie Mac and Fannie Mae, moving the risk of default to federal taxpayers. For example, a 2020 study found:

    > …local lenders are transferring risk in high-risk coastal geographies in the Southeast Atlantic and Gulf Coasts (U.S.) through increased securitization of mortgages.

5. **Macroprudential Risks to Economy:** More extreme storms and rising seas will drive significant losses of coastal property in the decades ahead, and these losses, together with other climate change impacts, have the potential to cause damage to the wider economy. In 2021, the Financial Stability Oversight Council within the U.S. Department of the Treasury concluded:

    > Climate change is an emerging threat to the financial stability of the United States. In the United States and across the globe, climate-related impacts in the form of warming temperatures, rising sea levels, droughts, wildfires, intensifying storms, and other climate-related events are already imposing significant costs upon the public and the economy.

The coastal property insurance system (i.e., private and state-managed property insurance and federal flood insurance) can act as a buffer to moderate this risk, but may fail to deflect economy-wide risks if it operates inefficiently (e.g., offers high prices and limited coverage and availability).

IV. Regulation and Oversight of the Coastal Property Insurance Market

A combination of regulation and related policies and programs can create a coastal property insurance system that meets national goals.

In the case of federal flood insurance, Congress can amend the authorizing statutes, the Federal Emergency Management Agency (FEMA) can revise regulations, and local governments can implement their own local ordinances and programs. Some private insurance companies also offer supplemental flood insurance.

Regulation of the private-sector property insurance market is more complicated than regulation of federal flood insurance, and includes several elements:

1. **Federal Legislation:** Federal legislation is one tool for managing insurance markets**.** In January of 2024, Rep. Adam Schiff (D-Ca.) introduced legislation to "stabilize the home insurance market while ensuring vulnerable communities are not excluded from coverage." The bill:

   > …would create a federal catastrophic reinsurance program to insulate consumers from unrestrained cost increases by offering insurers a transparent, fairly priced public reinsurance alternative for the worst climate-driven catastrophes.

   More specifically, the bill would:

   - provide for insurance company payments to a "Federal Catastrophe Reinsurance Fund," while capping insurers' liability in the case of a catastrophic event above a threshold developed by the Secretary of the Treasury and an advisory committee of experts;
   - discontinue the National Flood Insurance Program;
   - create a prevention loss grant program for states, giving priority to states with up-to-date building codes that give priority to low- and moderate-income consumers with funding of $50-75 billion per year; and
   - create a new state grant program to help make insurance affordable for low-income people.

2. **Federal Oversight:** The Federal Insurance Office (FIO) within the Department of the Treasury provides general oversight of insurance. Recently, the FIO has focused on

climate change impacts on insurance, issuing a major report with detailed recommendations focused on state actions.

A more general report looking at a range of financial risks related to climate change by the Financial Stability Oversight Council made a range of recommendations related to climate risks, including risks related to insurance.

Other aspects of federal oversight include:

- Congress can hold oversight hearings. For example, the Senate Banking Committee has held extensive hearings on climate change issues, including climate risks to coastal property, and recently began an investigation of climate change and insurance issues;

- Federal agencies with housing responsibilities can implement policies to influence home insurance markets. For example, the Federal Housing Finance Agency issued a *Request for Input* on climate and disaster risk in 2021.

- Finally, a key strategy for reducing insurance costs due to disasters and a changing climate is to address the underlying causes of rising costs by implementing programs to mitigate disasters, respond to disasters, reduce release of greenhouse gases causing climate change, and adapt more effectively to increasing climate risks. Responsibilities for these actions are shared among many agencies but coordinated by the White House Climate Policy Office.

3. **State Oversight and Regulation:** State insurance commissioners, working under the direction of governors and state legislatures, have significant authority to oversee and regulate the practices of insurance companies. State commissioners work together within the National Association of Insurance Commissioners (NIAC). NIAC sponsors a Climate and Resiliency Task Force that supports dialogue on climate risk and resiliency issues.

   NAIC recently adopted a new standard for insurance companies to report their climate-related risks, in alignment with the international Task Force on Climate-Related Financial Disclosures (TCFD). In addition, NAIC manages a "Climate Risk Disclosure Survey" that states can require insurance companies to use to disclose climate related risks. In 2021, some 15 states participated in the disclosure survey.

4. **State Legislation for Insurance Programs of Last Resort:** When national oversight and state regulation fail to result in insurance options that the state considers needed, a state legislature can implement a state-run insurance program to offer insurance as a last resort. State programs are operating in Florida, Louisiana, and California.

5. **National Nonprofit Organizations:** Although national nonprofits have no regulatory authority over private coastal property insurance companies, they play a role by gathering information about storm and sea level rise risks to coastal property and developing recommendations for state and federal actions to improve the coastal property insurance market, as well as the NFIP.

   For example, the nonprofit organization CERES and the Wharton School recently collaborated to develop a report calling for insurance market improvements related to climate-related disasters to make insurance more inclusive (i.e., to "make appropriate and affordable insurance available to those unserved or underserved by the market").

   Other national nonprofit organizations working to improve the coastal property insurance market include the Union of Concerned Scientists, the Consumer Federation of America, and the Environmental Defense Fund.

6. **Other Organizations:** Some other organizations have addressed policy issues related to climate change and insurance. For example, the Deloitte Center for Financial Services conducted a survey of insurance regulators on climate risk, finding:

   > With losses mounting, insurers can no longer avoid or postpone addressing the impact of changing climate on their underwriting, pricing, and investment decisions, as well as their bottom lines.

   The report on the survey makes recommendations for actions by insurance companies to address climate-related risks, including working to "alleviate climate risk exposure."

V. National Goals for the Coastal Property Insurance Market

Given the shortfalls in the coastal property insurance market, two key questions will arise for discussion among the webinar panelists:

- What should be the national goals for operation of the private coastal property insurance market? (i.e., what are the attributes of a national coastal property market that are in the national interest?)

- What national programs and policies might governments and insurance providers adopt to best guide the coastal property insurance market toward desired national goals?

The question of the attributes of the coastal property insurance market that are in the national interest is not widely addressed in the literature. One exception is the report by CERES and Wharton School on insurance for climate-related disasters, which concludes that "our current insurance system is not meeting the needs of some of the most vulnerable," and that new approaches "are required to make the financial protection of insurance available to everyone." The report describes five "principles" focused on a more inclusive insurance market, including:

- **Affordable:** All people have access to affordable insurance, or risk transfer mechanisms for financial security that match their capacity to pay.
- **Accessible:** People can engage with insurance markets easily, and products are designed to deliver payments smoothly.
- **Transparent:** Policy terms and the claims processes are transparent for consumers, and market data is available for public and academic research.
- **People-centered:** The goal of insurance product design, program development, and market regulation is centered around the specific financial security needs of individuals and households and the goals they set for themselves.
- **Just:** Availability, rates, response, and payments are fair.

To prompt discussion of goals for the coastal property insurance system, some key goals are outlined below, along with some suggested policies and programs to accomplish the goals. These goals are that:

1. Coastal Property Insurance Markets are Sustainable
2. Coastal Property Insurance Rewards Risk Mitigation
3. Coastal Property Insurance Coverage and Terms Provide Meaningful Economic Benefits to Homeowners
4. Coastal Property Insurance is Affordable for Low-Income People
5. Coastal Property Insurance is Sufficiently Dense Geographically to Support Community-Wide Recovery
6. Coastal Property Insurance Manages Insurer Exits from High-Risk Areas
7. Coastal Property Insurance is Sufficient to Sustain Federally Backed Mortgages

Each of these goals is described below along with possible supporting policy options and strategies.

1. **Coastal Property Insurance Markets are Financially Sustainable:** The private insurance market and state-managed funds need to operate successfully (i.e., provide competitively priced coastal property insurance and reliable support services on a continuing basis) in a changing environment. A key feature of sustainable markets is that insurance is priced to closely reflect the current and future risk of damage to the insured property (i.e., site-specific risk assessment relying on high-quality risk data).

   Policy options to support this goal include:

   - development of reliable and nationally consistent data on risk to coastal property (e.g., storm frequency and intensity, rates of sea level rise over time) on a site-specific basis;

- rate-setting mechanisms that result in rates closely reflecting site-specific risk while being sufficient to support risk transfer and insurer operations and constrained by competition (e.g., risk-based rates); and
- management of transition to risk-based rates and subsequent rate adjustments that minimize annual percentage increases to avoid homeowners opting out of insurance (e.g., cap on annual rate of increase in premiums).

2. **Coastal Property Insurance Rewards Risk Mitigation:** Risks to coastal property are steadily increasing, and the cost of insurance will increase to a corresponding degree unless mitigated by the actions of property owners or local, state, or federal governments (i.e., adaptation actions to minimize risks can hold down rates even as risk increases). The National Building Council reports that mitigation saves up to 13 dollars for every dollar invested. The National Mitigation Investment Strategy also recommends linking financial products such as insurance to mitigation investments at various scales.

   The coastal property insurance system can help moderate the long-term rate of increase of insurance premiums by encouraging actions by homeowners to adopt practices or measures (e.g., building code compliance) at a site-specific scale that are proven to reduce risk and damages, and rewarding these actions with incentives/rate reductions.

   In addition, insurance companies and programs should reward governmental risk-mitigation policies and investments (e.g., investments ranging from physical protection such as sea walls and living shorelines to building elevation to relocation) with rate reductions on an appropriate geographic scale. (Note: this model is similar to the Community Rating System in the National Flood Insurance Program).

   Policy options to support this goal include:

   - development of an industry-standard schedule of property-specific homeowner guidance for critical coastal property risk mitigation actions and associated ranges of rate reductions;
   - design of policy statements and billing to identify rate savings accomplished through mitigating at a property or larger scale;
   - development of nationally consistent databases of individual governmental coastal property mitigation measures that can be considered as a basis for risk-based rate reduction or moderation;
   - state financial support for homeowner mitigation measures that can translate to premium reductions; and
   - state regulatory requirements for insurance market reporting of the degree and type of mitigation actions accounted for in rates and extent of rate reductions.

3. **Coastal Property Insurance Coverage and Terms Provide Meaningful Economic Benefits to Homeowners:** Insurance policy coverage of possible property damages

should be sufficiently broad to assure that property owners are covered for likely types of damages (other than flooding covered by the National Flood Insurance Program), as needed to meaningfully minimize economic impacts on homeowners, communities, and the economy more generally.

Policy options to support this goal include:

- establish a national minimum standard for coastal property coverage and terms;
- require insurance companies and programs to notify prospective policyholders of the national standard and to report on overall compliance with the standard;
- have federal financing authorities (e.g., Fannie Mae and Freddie Mac) limit their acceptance of mortgages for securitization to properties meeting standards for property insurance coverage that meet a minimum standard.

4. **Coastal Property Insurance is Affordable for Low-Income People:** Unfortunately, risk-based rates that reflect mitigation efforts and provide meaningful coverage may be unaffordable for people with lower incomes. Low-income homeowners who have a mortgage are less able than wealthier homeowners to budget for long-term continuing rate increases driven by growing climate risks. The scenario of steadily growing insurance costs as part of a mortgage supported by a limited personal budget will drive some homeowners from their homes or cause significant financial hardship.

   Low-income homeowners who own their home outright are not generally required to carry property insurance, or federal flood insurance, as a condition of ownership. Still, storm and flood damage to the home can be economically devastating, displacing people and forcing them to draw on a range of government services. So, it is in the government's financial interest to help low-income coastal homeowners be covered by meaningful property insurance (i.e., risk-based, mitigation-focused, and sufficient coverage).

   A low-income property insurance subsidy might be paid for through rate increases on wealthier policyholders or by taxpayers more generally (i.e., supplemental appropriations administered by the government to policyholders or paid to insurance companies). Because subsidizing low-income policyholders through increased rates on wealthier policyholders will further increase rates generally and drive some homeowners away from insurance, it is in the government's interest to pay for low-income property insurance.

   Policy options to support this goal include:

   - insurance companies could be required to identify and write property insurance policies for low-income coastal property owners without charge, and then apply to be reimbursed for costs from a coastal property insurance rate stabilization fund supported by the state or federal government;

- a state might fund a coastal property price stabilization fund through a small fee on coastal lodging room rates or related activities;
- a federal coastal property insurance rate stabilization fund might be funded by general revenues (see proposal in INSURE Act); and
- subsidies might be limited to primary residences and to amounts sufficient to cap a rate increase at the area rate of inflation.

5. **Coastal Property Insurance Is Sufficiently Dense Geographically to Support Community-Wide Disaster Recovery:** It is important that property insurance be in effect for a critical mass of properties in an area, so that the collective benefit of the insurance damage payments is sufficient to support substantial disaster recovery of a community in conjunction with federal disaster relief and other funds. In some coastal places, the percentage of property owners not required to have property insurance as part of a mortgage, and having forgone insurance, may be high enough that community- or regional-scale recovery from a disaster is partial and slow.

   Limited and slow recovery adds to human misery, but also drives additional costs of government services. It is in the government's financial interest for the proportion of properties in a coastal community or region to be high enough to support robust, timely recovery. This insurance density will minimize the economic impacts on homeowners, communities, and the economy more generally, as well as minimize federal disaster assistance costs.

   Policy options to support this goal include:

   - insurance companies and programs should annually report to the state and federal governments the number of properties in a coastal community with insurance in effect, including an estimate of the percentage of all properties insured and the community risk profile;
   - state and federal governments should identify coastal communities where the proportion of properties with property insurance policies is not likely to be sufficient to support recovery from likely damage from storms and rising sea level;
   - local, state and federal governments should work with insurance companies to develop outreach and education programs to disclose risks and promote increased insurance uptake in high-risk, underinsured communities; and
   - state and federal governments should give low-income property owners in these underinsured communities priority for insurance subsidies with the available appropriations.

6. **Coastal Property Insurance Manages Insurer Exits from High-Risk Areas:** As storms become more frequent and intense and higher sea levels inundate existing neighborhoods, insurance providers will be unable to insure properties in these high-risk areas even at risk-based rates (i.e., the near-term substantial or total loss of a property

makes renewing existing policies or writing new policies in the high-risk area financially unsustainable).

A key goal for the coastal property insurance system should be to anticipate the need to terminate existing policies and avoid writing new policies in high-risk areas, and to manage the transition out of high-risk areas in a way that protects the financial stability of the insurance providers while minimizing disruption for property owners and coastal communities. A consequence of this approach is that disaster response plans will need to anticipate not rebuilding in high-risk areas and provide for transition and relocation from high-risk areas to pre-defined alternative, safer areas.

Policy options to support this goal include:

- state and federal agencies cooperate with insurance industry representatives to identify high-risk coastal areas (e.g., areas with existing or future high storm risks or expected to be inundated by rising seas within 50 years) on an annual basis;
- insurance providers are prohibited from writing policies for new construction in identified high-risk areas;
- insurance providers agree to give notice to existing policyholders of their location in a high-risk area on each renewal of the policy, including the potential for future rate increases;
- insurance providers agree to provide existing policyholders in high-risk areas with notice of policy termination not less than five years prior to termination;
- in the case of existing policies for properties in high-risk areas that suffer damage greater than fifty percent of the value of the property, insurance policies are amended to provide that the property will not be reinsured; and
- federal and state funding for property buyouts is focused on high-risk areas, including properties denied insurance due to substantial damage.

7. **Coastal Insurance is Sufficient to Sustain Federally Backed Mortgages:** A key purpose of coastal property insurance and federal flood insurance is to ensure that financial institutions holding mortgages are protected from significant declines in value of a significant number of mortgaged properties. Maintaining adequate property and flood insurance is a mortgage requirement, but some mortgaged properties are underinsured (e.g., not paying premiums that are sufficient to cover likely losses because increased storm flood and sea level rise risks are not fully reflected in premiums).

   In addition, the flood risk maps developed for the National Flood Insurance Program are often outdated, so that flood losses increasingly occur to properties in areas outside of mapped flood risk areas where flood insurance is not yet a requirement of a mortgage. Private property insurance companies sometimes rely on federal flood maps to evaluate flood risk, and thus may underestimate risk in both mapped flood areas (e.g., due to outdated maps) and areas not mapped as having flood risk. In addition, federal flood risk maps only reflect sea level rise to the extent that future mapping looks backward to identify increased flood risk in an area due to sea level rise that has occurred. The long lag time in accounting for sea level rise driving higher storm surges and more general, wider-scale inundation means premiums often are insufficient to cover actual losses. This problem will grow as the rate of sea level rise accelerates in the decades ahead.

Private mortgage companies increasingly recognize that the risk of losses from underinsured coastal properties is high and likely to increase. Rather than carry these high-risk properties, they are increasingly offloading the risk by securitizing the risky mortgages through a sale to a federally backed mortgage institution (e.g., Fannie Mae or Freddie Mac). By accepting these mortgages for underinsured properties, Fannie Mae and Freddie Mac are assuming the risk that storm and sea level rise damage will result in losses that prevent repayment of the mortgage (e.g., a home is a total loss, mortgage payments to the institution stop, and the property that provided collateral for the mortgage is no longer of any value).

Large federal financing institutions can cover some losses from underinsured coastal property, but more severe storms and rising seas will drive up the number and size of losses. As these losses increase, they become too big to be managed with the resources of the financing institutions. Since these institutions are essential to the functioning of the national real estate economy, it is likely that significant coastal property losses will be covered by supplemental funding from the federal government (i.e., a taxpayer bailout).

Given that millions of coastal homes are at risk of total loss to storms and rising seas, any bailout could divert funds from other critical efforts to adapt to coastal flood risks or to fund government programs more generally. (Note the same trends might also result in unsustainable losses from the NFIP, resulting in taxpayer bailout of that program as well.) A key goal of a coastal property insurance system should be to minimize the risk of significant taxpayer subsidy of coastal mortgages and diversion of federal funds to cover mortgage losses.

Policy options to support this goal include:

- provide that federal financing authorities (e.g., Fannie Mae and Freddie Mac) limit their acceptance of mortgages for securitization to those properties with insurance coverage (i.e., private property and NFIP) that is able to provide loss payments that are at least equal to the value of the mortgage (i.e., insurance is sufficient to avoid taxpayer loss);
- reduce underinsurance of individual policies by updating FEMA flood maps and improving them to cover areas at risk of flooding from both storms and sea level rise;
- require public reporting of federal securitization of coastal mortgages and the macro-level risk carried by federal financing agencies, including periodic stress tests of each agency.

Background Reading on
The Coastal Property Insurance Crisis

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2. *Is the $1 Trillion Coastal Housing Market a Future Financial Crisis?* UCLA Anderson Review; 2021; https://anderson-review.ucla.edu/is-the-1-trillion-coastal-housing-market-a-future-financial-crisis/

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6. *California Sustainable Insurance Roadmap;* California Insurance Commissioner; 2022; https://www.insurance.ca.gov/01-consumers/180-climate-change/upload/CA-Sustainable-Insurance-Roadmap-2022.pdf

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