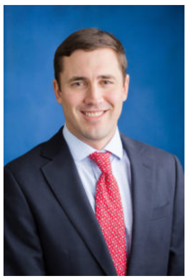
The Impact of Climate Change on the Insurance Industry And What it Means for Maine



Cale Pickford

By Cale Pickford for Maine REALTOR® Magazine

Climate change is increasingly causing severe weather events, posing significant risk to homes and businesses and displacing millions of people. In fact, a new Census Bureau tally shows that more than 3.4 million adults were displaced in 2022 by catastrophic weather events, around 1.4% of the U.S. adult population. Most of those displacements were short term but the census figures also show that 16% of those displaced adults never returned home, and 12% were out of their homes for more than six months.

In addition to the social cost that these severe weather events pose, in 2022 the U.S. experienced 18 separate weather and climate disasters costing at least $1 billion, the third highest number in a calendar year, behind the 22 events in 2020 and 20 events in 2021. Clearly this trend indicates that the high frequency and severity of extreme weather events affecting people's lives and livelihoods represents the new normal creating far reaching economic and social impacts that will indelibly shape the future of where and how we live in our country and the world beyond.

The rise in population and wealth over the past decades is an important factor in these increased costs. This trend is further complicated by the fact that much of the development has taken place in highly vulnerable areas like coasts, wild-land urban interface, and river flood plains. Vulnerability is especially high where building codes are insufficient for reducing damage to extreme events. This challenge is compounded by the fact that extreme weather events are hitting areas that have not experienced these storms in the past and are therefore far more vulnerable. One example is the deadly tornadoes that devastated parts of Tennessee and Kentucky in 2022, two states historically considered to be well east of tornado prone areas.

Ultimately, this means that climate change and associated severe weather events are, in some ways, destabilizing society, and relevant to this column, most certainly destabilizing the insurance industry. Prices have been driven up and severe storm risk has pushed many insurers out of high-risk markets. Insurance markets are in crisis in Florida, Louisiana, and California and states like Colorado and Oregon are not far behind. As private insurers pull out of these states, homeowners are forced to insure through state-run insurance plans – sometimes called FAIR plans – that cover people who cannot buy insurance from a company. As more people are forced into these plans, the risk that they become insolvent increases dramatically. In California, the state-run FAIR plan is running a $332 million deficit while it charges premiums that are too low and has limited reinsurance to cover claims. If these plans go broke, it is the responsibility of the insurers operating in the state to pay claims based on an unlimited assessment.

Insurers in Maine haven’t been as directly impacted by severe weather-related losses. From the perspective of climate risk, Maine is still seen as a relatively safe place to insure. Our broad selection of high-quality insurers and relatively affordable rates stand in sharp contrast to other parts of the country. With that said, we’re not at all immune to the macro trends characterized by increasing rates and an unwillingness of many insurers to cover what is perceived to be higher risk homes and commercial properties. Reinsurance, the insurance that insurers buy to offset large losses, has increased in cost dramatically in response to 3 years of unprecedented losses. By its nature, reinsurance costs are spread across a broad base and Maine insurance consumers are ultimately footing some of the bill for the large losses in other states. As mega-disasters ultimately force population shifts and disrupt the real estate market in high-risk states through prohibitively expensive or unavailable insurance, Maine will benefit from an influx of new homebuyers. Expect this influx to impact the entire spectrum of the market, from luxury homes to affordable housing. While this is a boon to those in the real estate industry it also has the effect of driving home prices to levels out of reach for many who live and work in Maine. A complicated problem requiring a thousand separate solutions to address.

In the meantime, we can count ourselves lucky to call Maine home, even if it is a home that will look a little different in the years to come.

The Classic Question: What is a Home Worth? Valuing a Home from an Insurance Perspective

By Cale Pickford
For Winter 2023 Maine Realtor Magazine

Real estate agents know that valuing and pricing a home is more art than science. In most parts of the country, this question is a lot easier to answer, as homogenous homes in cookie-cutter subdivisions create a commodity-like price environment while homes in Maine are much more often one-of-a-kind assets.

The classic market-based answer to the question of value is that something is worth what someone is willing to pay for it. To get there, real estate agents look at recent comparable sales but often agents go with their gut, using recent sales and market momentum as a guide.

The seller’s situation can also guide pricing. I would argue that the art of valuing the home is the most important role that the real estate agent plays in both the buy and sell side of the transaction.

Valuing a home from an insurance perspective is a different, but no less important job, and in many cases just as subjective. Insurance agents look to insure homes at the cost to replace new, assuming a total loss. Generally, you'd also add in the cost to demolish the damaged structure and dispose of the debris. If the market value of a home and the replacement value of the home are the same, that is purely coincidence.

Now, how do insurance agents get to the correct valuation?

Software

All insurance agents have access to replacement cost estimating software. The agent fills in data about the home such as building shape, square footage, year built, basement type, number of bathroom and so on. The agent can select grades from drop down menus to assign the quality of the construction. These options range from basic contractor grade to custom luxury, with several grades in between. Agents can also fill in fields for flooring, built ins, extra features, with thousands of options and exponentially more combinations. The downside with this software is that it is only as good as the assumptions built into it by the developer and it probably works best with newer, modern built homes in regions with developer-based construction. Still, this is an important tool.

Conversations with local contractors and architects

These are the professionals who have the real time information. They know exactly what their material, labor and subcontractor costs are, and that information is always going to be more regionally accurate. Most builders and architects can break down the cost to rebuild in a per square foot number and the agent can use that as a range to overlay with the valuation report generated by the replacement cost software.

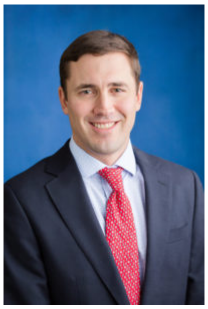
Valuation specialists working with insurers

Insurers are paying the claims, so they have a lot of data on hand about the cost to replace a home. Many insurers have specialists in-house or they work with third-party inspectors to inspect homes and perform their own replacement cost analysis. A diligent agent will have a conversation with the insurer before issuing coverage to make sure they are comfortable with the replacement cost number. Working with an insurer who inspects the home (almost always after the policy is issued) should provide peace of mind to the homeowners that a professional has seen their home, documented its unique features and come up with their own cost to replace.

With all these tools at the insurance agent’s disposal, coming up with an accurate replacement cost number is still part science and part art. A diligent agent will always err on the high side because a homeowner does not plan to have an insurance claim. When you’re building a new home, you can work within the contractor’s schedule and perhaps even get several bids and select the lowest option. This is usually not the case following an insurance loss. Also, historic homes cost far more to replace than the equivalent modern home due to unique materials, dimensional lumber, and custom finishes. The best tip for homeowners is to work with an independent agent who understands the importance of being properly insured and has the expertise to work collaboratively with the homeowner to get there.

Top tip: Look for insurance policies that offer guaranteed replacement cost coverage. A guaranteed policy is a promise to rebuild regardless of the limit of coverage: essentially unlimited. If that is not available opt for one that provides extended replacement cost, usually expressed as a percentage of the dwelling limit on the policy: for example, 125% or 150% extended replacement cost.

Insurance Trends for 2022 and Beyond



By Cale Pickford
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The insurance market, like the real estate market, can serve as a window from which to view society and the economy. Insurance companies look to strike a balance between their tolerance for risk and their mandate to generate profits. The push and pull of these two competing factors are further complicated by the rapid rate of change in today's world. Insurers look to predict the future with data from the past, and in this changing world, they are having trouble keeping up. Here are three trends that will dominate the insurance marketplace for the coming year.

Inflation is on everyone's minds these days – for good reason. Across the economy, the cost of just about everything has gone up at rates not seen for more than 40 years. This means that insurance companies, too, must pay more to adjust a loss.

In addition to increased costs, shortages of labor, materials and parts has meant that it takes far longer to fix damages and get people back into their homes and cars. Many insurance policies pay for the insured to rent a car or home until repairs are completed, this time element increases the total cost of the loss significantly. Industry data suggests that claims costs are up as much as 50% to 100% over pre-pandemic levels. Because of state regulations, increasing insurance rates can be a slow process, but there is no question that over the next few years insurers may increase their rates to reflect the rising costs of insurance claims.

In the context of this inflationary environment, having the right insurance has never been more important. Look for auto insurance policies offering higher limits for temporary rental car coverage, and policies which allow the client to select both the repair shop and original equipment instead of aftermarket parts. For homeowners' policies, look for carriers providing guaranteed replacement cost coverage (which means they will rebuild the home to the same standards, regardless of the limit of coverage on the policy) and high or uncapped coverage for loss of use (the coverage that will pay to rent a home if you're displaced).

Another trend which cannot be understated is the impact of **climate change** on the insurance industry. Extreme weather events generating billions of dollars in damaged property and often loss of life seem to be weekly occurrences. The impact of climate change is no longer hypothetical, and the private insurance industry is reeling from its impact. In particularly hard-hit states such as California and Florida, the private insurance industry is only offering homeowners policies which exclude the primary regional cause of loss such as fire and wind. These policies usually need to be complimented by a separate wind or fire policy underwritten by a state-sponsored insurance pool. While Maine seems more protected from extreme weather events, that trend could change. Regardless, insurers are motivated to spread out the burden of higher rates across a national customer base. In this context, consumers should work with an independent agent to identify regional insurers who do not have as much exposure to catastrophic loss prone regions or who identify Maine and Northern New England as a market for focused growth or hedge against more loss prone areas.

Cyber security and cyber insurance rounds out this list of top trends. The COVID-19 pandemic forced organizations to shift their workforce to remote work and surveys suggest that a high percentage of workers continue to work remotely. Remote working, accelerated digitization, and an increase in reliance on cloud-based services has created new opportunities for ransomware attackers. The frequency and sophistication of these cyber-attacks are on the rise. Hackers are also becoming more sophisticated by using social engineering attacks, whereby an individual is targeted and enticed to click a link to download malware providing access to a computer or network.

An important tool for preventing hackers from gaining access to computer system is multi-factor authentication (MFA). Though MFA is regarded as the gold standard of authentication, malicious attackers are finding ways to get around it – specifically, authentication carried out via SMS or phone calls. App-based authenticators and security keys are seen as the best option today, but we can be sure that hackers will be looking for ways to exploit vulnerabilities in these systems, too.

Cyber liabilities are here to stay. Every business and household is at risk and having a plan for cyber security complimented by cyber liability insurance is a must for 2022 and beyond.

Insurance continues to be a critically important aspect of the economy as it provides individuals and businesses with a tool to offset risk. Working with an independent insurance advisor who understands the evolving nature of risk along with the associated loss control strategies and insurance solutions is a critical element of financial security and well-being.