



NATIONAL ASSOCIATION OF REALTORS®

The Voice For Real Estate®

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**STATEMENT OF
GARY THOMAS ON BEHALF OF
THE NATIONAL ASSOCIATION OF REALTORS®**

Before the

**The Subcommittee on Housing and Community
Opportunity of the House Committee on Financial
Services**

“Perspectives on Natural Disaster Insurance”

March 27, 2007

Introduction

Thank you, Chairwoman Waters, Ranking Member Biggert, and Members of the Subcommittee for inviting me to testify here today before the Subcommittee on Housing and Community Opportunity and present the views of the National Association of REALTORS[®] on the issue of natural disaster insurance.

My name is Gary Thomas. I am a REALTOR[®] from Aliso Viejo, California where I am CEO of RE/MAX Real Estate Services, one of the six largest RE/MAX brokerages in the nation. In 2001, I had the honor of serving as the President of the California Association of REALTORS[®]. Currently, I serve as Chairman of Real Estate Business Services subsidiary of the California Association and as Liaison to NAR's Public and Federal Issues Group.

The National Association of REALTORS[®] is America's largest trade association, representing more than 1.3 million members involved in all aspects of the residential and commercial real estate industries. NAR is the leading advocate for homeownership, affordable housing and private property rights.

Overview

The catastrophic events of 2004 and 2005 have shown the need for a comprehensive, forward-looking natural disaster policy. Such a policy would recognize that property owners, private insurance markets, and all levels of government must work together in order to successfully address the problems (e.g., lack of available and affordable property insurance) currently plaguing disaster-prone areas.

The availability and affordability of property insurance is, at its core, a consumer issue. The importance of available and affordable insurance to homeowners, commercial property owners and those who would like to own their own home or place of business cannot be

overstated. This is something that your constituents, Madam Chair, have long understood since Californians have dealt with problems of insurance availability and affordability numerous times, most recently after the Northridge earthquake. Unfortunately, it is also something that consumers nationwide – even those who are not in what have traditionally been considered “disaster-prone” areas – now know all too well.

The National Association of REALTORS® believes that any real solution to the insurance problems now facing this country must go beyond a discussion of natural disaster insurance and include a comprehensive natural disaster policy that addresses, but is not limited to, insurance availability and affordability. A comprehensive natural disaster policy should take into account the responsibilities of multiple actors including property owners, insurance companies and each of the different levels of government in preparing and paying for future catastrophic events. Consequently, although this hearing is titled “Perspectives on Natural Disaster Insurance,” my testimony today offers suggestions for what REALTORS® believe must be a comprehensive approach to addressing future catastrophic natural disasters.

Residential and Commercial Properties at Risk

A strong real estate market is the linchpin of a healthy economy, generating jobs, wages, tax revenues and a demand for goods and services. In order to maintain a strong economy, the vitality of residential and commercial real estate must be safeguarded.

Today, insurance availability and affordability concerns are not limited to the Gulf Coast region. We have heard from REALTORS® in numerous states, including New York, New Jersey, South Carolina and North Carolina, expressing concerns about the availability and affordability of property insurance. Their insurance concerns extend beyond homeowners’ insurance and include multifamily rental housing and commercial property casualty insurance.

Insurance is a key component to financing the purchase of real estate. Without property casualty insurance, lenders will not lend; without insurance, borrowers are typically in default of their mortgage terms. The limited availability and high cost of insurance, therefore, not only threatens the ability of current property owners to hold onto their properties, but also to slow the rate of housing and commercial investment in these communities. Either of these threats could, in turn, further delay the rebuilding of communities on our storm-ravaged coasts.

The inability to obtain affordable insurance is a serious threat to the residential real estate market, impacting not only single family detached homes, but condominiums, co-operatives and rental units as well. New home purchases, resale transactions and housing affordability are affected in the following ways:

- **Homeowners' insurance is a necessary component in securing a mortgage and buying and selling a home.** If a potential homebuyer is unable to obtain or afford the required insurance, the sale will not be completed. As a result, potential homebuyers are excluded from the market.
- **The cost of owning a home is directly tied to insurance costs.** Homeowners are required by their mortgage lenders to maintain homeowners insurance, regardless of its cost. If the homeowner is unable to afford the cost of that insurance, the mortgage is in default and the lender may foreclose. If disaster insurance coverage is required, potential buyers may choose not to purchase a home because the insurance they need is too expensive. If disaster coverage is optional but expensive, owners may choose to go unprotected.
- **Insurance costs impact rent levels.** Insurance costs incurred by multi-family property owners are ultimately passed on to tenants through higher rents. This impacts housing affordability, particularly for low-income renters.

Many of NAR's commercial members in the Gulf Coast and coastal regions have also reported problems with commercial insurance availability and affordability. Members have experienced large increases in premiums-- in some cases more than four-fold with concurrent increases in deductibles and decreases in coverage -- and in some cases, a complete lack of availability. These changes put the property owner at greater financial risk to recover from losses, while also affecting property values since dramatic insurance increases often cannot be passed on to tenants. For example, in the multifamily housing sector, the ability to pass on increased insurance costs in the form of higher rent is often limited by market conditions, rent stabilization laws and strict limits imposed on federally subsidized landlords. The commercial property owner faces similar problems because leases may cover more than one year and may include limitations on the amount of expenses that may be passed on to the tenant. Thus, when insurance costs rise from \$0.10 to \$0.50 cents per square foot, the landlord must absorb most of the increased costs.

Often it is the smaller property owner that suffers the greatest. Small owners cannot offset the increases in insurance costs for one property with lower insurance costs in other parts of the country; nor are they able to negotiate a lower multiple property rate. In commercial real estate, there is a point at which insurance becomes unaffordable -- when insurance expenses are so high that the property no longer generates sufficient income to cover expenses. This problem forces many owners to sell their property.

Catastrophic Natural Disasters are a National Issue

The catastrophic events of 2004 and 2005 should serve as a wake up call that highlights not only the importance of having insurance, but also that individual property owners, insurance

companies, all levels of government, and taxpayers have a role in preparing for and recovering from future catastrophic events. The ongoing recovery from these storms shows that all taxpayers in the country have a stake in a federal natural disaster policy because their tax dollars are funding recovery efforts.

As a result of the 2004 and 2005 hurricanes, attention has focused on Florida and the Gulf Coast states, but other areas of the country are also susceptible to large-scale natural disasters. Damage caused by any of the following events could be as great as, if not greater than, that caused by Hurricane Katrina: a repeat of the 1906 San Francisco earthquake, another 1938 “Long Island Express” hurricane, or a significant seismic event along the New Madrid fault, which extends from northeast Arkansas, through southeast Missouri, western Tennessee, western Kentucky to southern Illinois. While it is true that not all areas of the country are susceptible to the large-scale disaster scenarios above, the effects of these disasters certainly would be felt by all taxpayers.

Elements of a Comprehensive Natural Disaster Policy

The National Association of REALTORS® encourages Congress to develop a comprehensive natural disaster policy that encourages personal responsibility, promotes mitigation measures, ensures insurance availability, and strengthens critical infrastructure (e.g., levees, dams, bridges, etc.). NAR supports the creation of a federal natural disaster policy that will promote available and affordable homeowners' insurance in disaster-prone areas.

NAR supports the creation of a federal policy to address catastrophic natural disasters that:

- 1) Protects property owners by ensuring that transparent and comprehensive insurance coverage is available and affordable, with premiums being reflective of the risk involved;
- 2) Acknowledges the importance of personal responsibility of those living in high-risk areas to undertake mitigation measures, including the purchase of adequate insurance;
- 3) Provides property owners adequate incentives to undertake mitigation measures where and when appropriate;
- 4) Acknowledges the importance of building codes and smart land use decisions while also emphasizing that proper enforcement of both is best left in the hands of state and local governments;
- 5) Recognizes the role of States as the appropriate regulators of property insurance markets while identifying the proper role of federal government intervention in cases of mega-catastrophes; and
- 6) Reinforces the proper role of all levels of government for investing in and maintaining critical infrastructure including levees, dams, and bridges.

NAR believes that now is the time for Congress to address a comprehensive natural disaster policy that includes natural disaster insurance. The lack of a national natural disaster policy has had a measurable direct impact on the availability and affordability of property casualty insurance in many parts of the country. The inability to obtain affordable homeowners' insurance is a serious threat to the residential real estate market – and thus, our economy.

Homeowners and commercial property owners need insurance to protect themselves, their families and their property in case of catastrophe. However, if insurance is not available or affordable, many make the unfortunate, but understandable, decision to purchase only the

minimal amount or type of insurance required. I would point out that this is precisely the decision many Californians have made - buying the required property casualty coverage but foregoing earthquake insurance due to its high cost. The problem with this rational economic decision is that if “the big one” hits, and people are not insured for that type of catastrophe, then the American Taxpayer, that is to say everyone in the country, will pay. NAR believes that people who bear risk should pay a fair share – by obtaining and maintaining adequate insurance coverage.

Property owners should have confidence that their homes and businesses will survive future catastrophic events. Appropriate mitigation measures can help to create that confidence. Federal and state governments can provide incentives (e.g., tax credits, insurance rate reductions) to property owners to undertake appropriate mitigation measures for their homes and businesses. Research conducted by the Multihazard Mitigation Council of the National Institute of Building Sciences found that a dollar spent on mitigation saves society an average of four dollars.¹

States are the appropriate regulators of property insurance markets, but there is a proper role for the federal government in addressing mega-catastrophes. Some disasters are just too large or unpredictable for the private market to deal effectively with the resulting damage. At some level, there may be an appropriate role for the federal government to intervene in insurance markets to prevent market disruption and insolvencies among insurance companies. The level of intervention, however, must be set at a level that will not interfere with normal market forces. The difficulty lies in determining the level at which such intervention would be appropriate

Finally, an essential part of a comprehensive natural disaster policy is the recognition of the basic responsibility of government at all levels to build and maintain infrastructure.

¹ Multihazard Mitigation Council, “Natural Hazard Mitigation Saves: An Independent Study to Assess the Future Savings from Mitigation Activities, Volume 1 – Findings, Conclusions and Recommendations,” National Institute of Building Sciences, Washington, D.C. (2005), p.5.

Hurricane Katrina was not the largest hurricane to ever hit the Gulf Coast, but the failure of the levees protecting New Orleans contributed significantly to the loss of life and property from that storm. USA Today reported on January 29, 2007, “The Army Corps of Engineers has identified 146 levees nationwide that it says pose an unacceptable risk of failing in a major flood.”² According to the article, 42 of these levees are located in California.³ The U.S. Army Corps of Engineers on February 1, 2007, released a list of 122 “Levees of Maintenance Concern” that includes 37 levees in California.⁴ Moving forward, we believe that all levels of government must do a better job of shouldering their respective responsibilities.

To summarize, we believe that it is in the best interests of all Americans to have a comprehensive federal natural disaster policy that includes aggressive mitigation and appropriate assumption of risk so that affordable insurance for homeowners and commercial properties is available. Having a comprehensive natural disaster policy is essential in the coming years. There is no guarantee that 2007 or any future years will be as benign for natural catastrophes as 2006. The question is not whether there will be another Katrina-like event in size and scope of destruction, but when. As we have learned, it is far less costly to prepare ahead of time than to fund recovery efforts.

Proposed Legislative Approaches

Congress has, with varying levels of success, debated and voted on natural disaster policies since the 1990s. The National Association of REALTORS[®] encourages a healthy and vigorous debate during the 110th Congress that leads to sound and productive legislation. NAR

² Peter Eisler, “146 U.S. Levees May Fail in Flood,” USA Today, January 29, 2007.
http://www.usatoday.com/news/nation/2007-01-28-levees_x.htm?POE=NEWISVA

³ Ibid.

⁴ See: U.S. Army Corps of Engineers, “Levees of Maintenance Concern,” Feb. 1, 2007.

supports the efforts of members of Congress who have introduced and co-sponsored legislation to address this critical issue.

Legislation introduced in the 110th Congress to date takes different approaches to addressing the natural disaster insurance issue. For example, Representative Ginny Brown-Waite has introduced two bills that attempt to address the issue of reinsurance, H.R. 330, the “Homeowners’ Insurance Availability Act of 2007,” and H.R. 91, the “Homeowners Insurance Protection Act of 2007.” Representative Carolyn Maloney introduced a similar bill, H.R. 4507, the “National Catastrophe Insurance Act of 2005,” in the 109th Congress.

Other legislation would create an incentive for insurance companies to increase reserves to help pay claims arising from future catastrophes. H.R. 164, the “Policyholder Disaster Protection Act of 2007,” introduced by Representative Bobby Jindal, provides for the creation of disaster protection funds by property and casualty insurance companies that would be used to pay policyholders' claims arising from future catastrophic events.

H.R. 920, the “Multiple Peril Insurance Act of 2007,” introduced by Representative Gene Taylor, would expand the National Flood Insurance Program to include coverage for windstorms.

H.R. 537, the “Commission on Catastrophic Disaster Risk and Insurance Act of 2007,” introduced by Representative Kendrick Meek, takes yet another approach by seeking to create a bi-partisan commission on insurance reform.

In addition to the aforementioned proposals, NAR encourages the consideration of additional proposals that would provide incentives for property owners to undertake mitigation measures, allow individuals to establish catastrophe savings accounts to pay for losses resulting from catastrophic events, strengthen the nation’s infrastructure, and ensure the long-term

viability of the National Flood Insurance Program. NAR believes that all reasonable proposals should be considered as part of a comprehensive solution to address future catastrophic events.

Conclusion

Thank you again for inviting me to present the views of the National Association of REALTORS[®] to the Subcommittee. The National Association of REALTORS[®] encourages Congress to develop a comprehensive approach to natural disaster preparedness that encourages personal responsibility, promotes mitigation measures, ensures insurance availability, and strengthens critical infrastructure (e.g., levees, dams, bridges, etc.).

Passage of an appropriate comprehensive national disaster policy is a top legislative priority for REALTORS[®] nationwide. We stand ready to work with you, Chairwoman Waters, the Committee on Financial Services and others in Congress to develop a responsible natural disaster policy that addresses the needs of consumers, the economy and the nation.

I would be glad to answer any questions that you or other members of the subcommittee may have.