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*The Voice For Real Estate®*

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**HEARING BEFORE**

**THE UNITED STATES HOUSE OF REPRESENTATIVES  
COMMITTEE ON FINANCIAL SERVICES  
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY  
AND  
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT-SPONSORED ENTITIES**

**ENTITLED**

**“APPROACHES TO MITIGATING AND MANAGING NATURAL CATASTROPHE RISK: H.R. 2555, THE  
HOMEOWNERS’ DEFENSE ACT”**

**TESTIMONY OF**

**CHARLES McMILLAN, CIPS, GRI**

**IMMEDIATE PAST PRESIDENT, THE NATIONAL ASSOCIATION OF REALTORS®**

**MARCH 10, 2010**

## **Introduction**

Thank you, Chairs Waters and Kanjorski, Ranking Members Capito and Garrett, and Members of the Subcommittees for inviting me to testify here today before the Subcommittees on Housing and Community Opportunities and Capital Markets, Insurance, and Government Sponsored Entities, and to present the views of the National Association of REALTORS® (NAR) on approaches to managing natural catastrophe risks.

My name is Charles McMillan, and I am the Immediate Past President of the National Association of REALTORS® (NAR). I have been a REALTOR® for more than 20 years, and am Director of Realty Relations and Broker of Record for Coldwell Banker Residential Brokerage, Dallas-Fort Worth. Along with being a REALTOR®, I have been active in my community, serving as past chairman of the Community Development Council of Fort Worth, the Tarrant County Affordable Housing Task Force, the Housing Subcommittee of Fort Worth, and a past director of the United Way of Tarrant County and of the Fort Worth Chamber of Commerce.

NAR is America's largest trade association, representing more than 1.2 million members involved in all aspects of the residential and commercial real estate industries. NAR is the leading advocate for property ownership, affordable housing and private property rights.

## **Overview**

Recent earthquakes in Chile and Haiti – occurring so close together and relatively close to the United States – should serve to remind all of us of the need for a comprehensive, forward-looking national natural disaster policy. Such a policy would recognize that property owners, the private insurance markets, and all levels of government must work together in order to successfully address the problems of not available and affordable property insurance currently plaguing many parts of the U.S. While we may not have experienced this level of devastation since the Northridge Earthquake in 1994 or Hurricane Katrina in 2005, we all know “the next big one” is not a question of if, but when. We cannot afford to wait any longer.

Today, U.S. policy toward natural catastrophe risk is largely reactive rather than proactive, case-by-case rather than comprehensive, and that has to change. The default approach of the federal government has been to wait and respond: wait for the next disaster and then respond by appropriating assistance to its victims. For example, when Hurricane Katrina struck the southeastern coastline, the federal government paid for much of the cleanup – all with taxpayer dollars. Of the total appropriated, \$26 billion went directly to under-insured property owners according to the General Accountability Office. That is \$26 billion that would not have been necessary or paid by taxpayers (including those not living near the U.S. coast) had proactive federal policies and programs been in place, to make property insurance more widely available and affordable. While we do not have a similar estimate for all U.S. natural disasters, the following table should offer a sense of the magnitude of the impact to taxpayers from continuing the current policy.

***TOP U.S. NATURAL CATASTROPHES***

<b>Rank</b>	<b>Date</b>	<b>Peril</b>	<b>Location</b>	<b>Estimated Damages (\$ Billions)</b>	<b>Estimated Damages Minus Insured Loss (\$ Billions)</b>
1	Aug. 2005	Hurricane Katrina	AL, FL, GA, LA, MS, TN	\$90	\$45
2	Aug. 1992	Hurricane Andrew	FL, LA	\$51	\$28
3	Oct. 2005	Hurricane Wilma	AR, IL, IN, KY, LA, MO, OH, PA, TX	\$24	\$13
4	Sept. 2008	Hurricane Ike	FL	\$24	\$12
5	Aug. 2004	Hurricane Charley	FL, NC, SC	\$20	\$11
6	Jan. 1994	Northridge Earthquake	CA	\$29	\$11
7	Sept. 2004	Hurricane Ivan	AL, DE, FL, GA, LA, MD, MS, NJ, NY, NC, OH, PA, TN, VA, WV	\$16	\$8
8	Sept. 1989	Hurricane Hugo	GA, NC, PR, SC, VA, Virgin Islands	\$14	\$7
9	Sept. 2005	Hurricane Rita	AL, AR, FL, LA, MS, TN, TX	\$13	\$6

(1) Property coverage only. Does not include flood damage covered by the National Flood Insurance Program. As of Sept. 2009.

(2) Adjusted to 2008 dollars by the Insurance Services Office, Inc.

(3) Data from National Hurricane Center 2006 data adjusted to 2008 dollars, except Northridge damage data from U.C. Berkeley

Sources: National Hurricane Center <http://www.nhc.noaa.gov/pdf/NWS-TPC-5.pdf>  
Insurance Information Institute ([www.iii.org](http://www.iii.org))

Pending before Congress is legislation that would begin to shift taxpayer burden back to property owners by incentivizing state-government and private-insurance efforts to increase property insurance availability and affordability. NAR believes that a workable solution to the insurance problems now facing this country must also go beyond a discussion of property insurance and include a comprehensive natural disaster policy. A comprehensive natural disaster policy should take into account the responsibilities of multiple actors including property owners, the insurance companies and each of the different levels of government in preparing and paying for future catastrophic events. Consequently, 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

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. 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 any single region of the country. We have heard those concerns from REALTORS® in numerous states, including New York, New Jersey, South Carolina and North Carolina, as well as the Gulf Coast region. A witness at this hearing will testify about the significant challenges California is currently facing in preparation for the next mega-quake. As many of you are no doubt aware, the most recent earthquake and aftershocks were not limited to Chile; while the world waited for the Tsunami to hit Hawaii, central Oklahoma registered a 4.4-magnitude quake that approached the state record of 5.5 in El Reno in the 1950's. Also in February, CNN reported another quake that rattled northern Illinois and could be felt from Georgia, Tennessee, Kentucky, Ohio, Indiana, Michigan, Iowa and Wisconsin. Natural disasters are challenges facing more than just the coasts of the U.S. They are a problem for the interior of the country too, and it is not limited to earthquakes or hurricanes but also to other natural events such as tornados and ice storms. Insurance concerns extend beyond homeowners' insurance and include multi-family 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 could be 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 communities across the nation.

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

- **Property insurance is a necessary component in securing a mortgage and buying and selling a home or building.** If a potential buyer is not able to obtain or afford the required insurance, the sale will not be completed. As a result, potential buyers are excluded from the market.
- **The cost of owning property is directly tied to insurance costs.** Property owners are required by their mortgage lenders to maintain insurance, regardless of its cost. If the property owner is not able 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 property 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 and commercial property owners are ultimately passed on to tenants through higher rents. This affects housing affordability, particularly for low-income renters.

Many of NAR's commercial members have also reported problems with commercial insurance availability and affordability. For example, members in coastal areas 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, the landlord must absorb most of the increased costs.

Often it is the smaller property owner that suffers the greatest. These are the owners of America's small businesses that are the engine of job creation and innovation and backbone of their local community and economy. But due to size, these owners are not as able to 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 property no longer generates sufficient income to cover expenses. This problem can force owners to sell their properties. It can also lead to mortgage default and even foreclosure, especially during an uncertain economy when there are little-to-no buyers. Additionally, individuals and families who lease apartment space in multi-family structure could be severely affected.

### **Catastrophic Natural Disasters are a National Issue**

Coupled with the recent reminders in Chile and Haiti, the catastrophic events of the past decade should serve as a wakeup call that highlights not only the importance of having insurance, but also the role that individual property owners, insurance companies, all levels of government, and taxpayers have in preparing for and recovering from future catastrophic events. The ongoing recovery from these events shows that all taxpayers in the country have a stake in a federal natural disaster policy because their tax dollars are funding recovery efforts.

While as a result of the 2004 and 2005 hurricane seasons, much attention has focused on the Gulf Coast states, 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. I already referenced recent quakes in northern Illinois and central Oklahoma – yet another reminder that fault lines are not limited to California alone. While it is true that not all areas of the country are as susceptible to the next major

hurricane; earthquakes, tornados, winter, ice and hail storms, tsunami, draught, wildfire, lighting storms – the effects of and costs of cleaning up after all of these potentially devastating events certainly are felt by taxpayers nationwide.

### **Elements of a Comprehensive Natural Disaster Policy**

NAR encourages Congress to develop a comprehensive natural disaster policy that encourages personal responsibility, promotes mitigation measures, ensures insurance availability, and strengthens critical infrastructure such as levees, dams, and bridges. NAR supports the creation of a federal natural disaster policy that will promote available and affordable property owners' insurance.

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 access to affordable property insurance. The lack of a U.S. natural disaster policy has had a measurable direct impact on property insurance availability in many parts of the country; the inability to obtain affordable insurance is a serious threat to the entire real estate market and thus, our economy.

Homeowners and commercial property owners need insurance to protect themselves, their families, their tenants and property in case of catastrophe. However, if insurance is not affordable, many make the unfortunate, but understandable, decision to purchase only the minimal amount or type of insurance required. As others will testify, 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 when “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 and insurance rate reductions) to encourage 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.<sup>1</sup> Experts point to Chile's preparation and mitigation efforts, and more specifically the stringency of the country's building codes, as one of the central reasons why the vast majority of the buildings there continue to stand after an earthquake that released 500 times the energy as the 7.0-magnitude quake that struck Haiti.

However, while an essential component of any workable solution to managing natural disaster risk, mitigation measures alone would not address the taxpayer burden for cleanup of under-insured properties – i.e., billions of dollars that would no longer be necessary if there were proactive federal policies and programs in place to make property insurance more widely available and affordable.

NAR strongly believes that 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 simply too large or unpredictable for states and the private market to deal effectively with the resulting damage. There is an “adverse selection” issue: too few are able to insure so the companies are not always able to collect the premiums necessary to cover the losses. At some level, there is 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 market forces.

We believe that it is in the best interest 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 2010 or any future years will be as benign for natural catastrophes as 2009. 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. NAR supports the efforts of members of Congress who have introduced and co-sponsored legislation to address this critical issue.

Legislation introduced in the 111<sup>th</sup> Congress to date takes different approaches to managing natural disaster risk. Representative Ron Klein (D-FL) has proposed to address the risk by offering more stable financing alternatives to and thereby reducing state reliance on an increasingly volatile global reinsurance

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<sup>1</sup> 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.

market. His H.R. 2555, the Homeowners' Defense Act would provide pre-qualified state insurance programs with access to federal reinsurance that supplements and smooths out the market-rate fluctuations over time. The bill would provide for a Catastrophe Obligation Guarantee, also the subject of S. 886 by Senator Bill Nelson (D-FL) and H.R. 4014 by Representative Loretta Sanchez (D-CA). Guaranteeing post-disaster state loans would encourage lending during a time of heightened market uncertainty. H.R. 2555 would also establish a National Catastrophe Risk Consortium, to allow state insurance programs to voluntarily pool and further spread the risk by issuing catastrophe bonds. Finally, the bill includes a mitigation grant program to reduce taxpayer exposure by preparing and dedicating significant resources to local building code enforcement, preparedness initiatives by the American Red Cross and others, and first responder needs.

All of H.R. 2555's provisions work together to offer a comprehensive federal backstop and guarantee for state insurance programs, not only to protect the private market from collapse but also to ensure that resources are available to rebuild after the next mega-catastrophe. The bill would succeed in creating a national policy to proactively address the inevitable, rather than waiting for the next crisis and then needing to rely upon taxpayer funded bailouts. We thank Representatives Klein for his efforts, and urge the Committee to hold a mark up at the earliest opportunity and consider this legislation the starting point for a responsible solution to the problem of decreasing availability and affordability of property insurance.

NAR would encourage consideration of additional proposals, for example, H.R. 308 ("Hurricane and Tornado Mitigation Investment Act") by Representative Gus Bilirakis (R-FL) to provide tax incentives for property mitigation. A separate bill by Representative Tom Rooney (R-FL), H.R. 998 (the "Policyholder Disaster Protection Act of 2007") would encourage disaster reserve funds by insurance companies to pay policyholders' claims arising from future catastrophe. We also support Representative Gene Taylor's (D-MS) H.R. 1264, the "Multiple Peril Insurance Act," which would expand the National Flood Insurance Program (NFIP) to include windstorms, although we expect that measure to be considered as part of the Committee's NFIP reform debate later this year. 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®. We urge Congress to develop a comprehensive approach to natural disaster preparedness that encourages personal responsibility, promotes mitigation measures, ensures insurance availability and affordability, and strengthens critical infrastructure.

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