The Re-Risking State
The Limits of Property Insurance in Florida

Taylor, Zac

Publication date
2024

Document Version
Final published version

Citation (APA)
Taylor, Z. (Author). (2024). The Re-Risking State: The Limits of Property Insurance in Florida. Web publication/site, Law & Political Economy (LPE) Project . https://lpeproject.org/blog/the-re-risking-state-the-limits-of-property-insurance-in-florida/

Source: Taylor, Z. (2024, May 29). *The Re-Risking State: The Limits of Property Insurance in Florida*. LPE Project. Retrieved June 13, 2024, from https://lpeproject.org/blog/the-re-risking-state-the-limits-of-property-insurance-in-florida

The Re-Risking State: The Limits of Property Insurance in Florida

Zac Taylor

Zac J. Taylor (@zacjtaylor) is Assistant Professor in the Department of Management in the Built Environment at Delft University of Technology.

PUBLISHED 05.29.24

This post is part of a symposium on the law and political economy of insurance. Read the rest of the posts here.

Florida's property insurance market is in crisis. Many of the Sunshine State's insurers are raising rates or pulling out of communities, zip code by zip code. The average Florida homeowners insurance premium rose to nearly $11,000 in 2023, with notably higher rates in coastal South Florida cities—the costliest in the nation. This brewing insurance affordability crisis is particularly acute for Florida's half-million housing cost-burdened households with mortgages, who must continue to purchase insurance or face default on their mortgage. That's because mortgage lenders require borrowers to maintain insurance—a measure designed to protect the banking system, but which also places many frontline households in a serious affordability bind.

This frontline geography of insurance-driven housing unaffordability alludes to deeper, structural troubles in Florida's real estate-driven political economy. Florida is a property state *par excellence*. Not only does real estate serve as a vehicle for household consumption and wealth-formation, but the sector also plays an asymmetrically large role in driving employment and economic activity in the state. Sky-high coastal asset values also prop up the state's public spending. Absent a statewide income tax, Florida's highly unequal and fragmented tapestry of local property tax districts play vital roles in financing the delivery of public services. Florida's financial fate is inextricably entwined with a real estate market facing existential climate risks—and insurance is the keystone that balances these tensions, at least for now.

While today's insurance crisis is many ways acute, it's not necessarily new. Nor is it unique to Florida. Over the past three decades, Florida's insurance market has been a site of tumultuous restructuring, often triggered by costly disaster losses—and attempts to manage that fall-out through public policy- and market-driven interventions.

Most notably, Hurricane Andrew's South Florida landfall in 1992 triggered great concern among insurers and public policymakers alike about how to finance high-loss, low-probability "tail events" like a major cyclone in ways that balance consumer affordability against insurer profitability. Andrew helped to spark the industry-wide uptake of new actuarial tools like catastrophe risk models and to inspire the design of novel risk financing instruments like catastrophe bonds. The storm also prompted the roll-out of expanded public insurance institutions in Florida and elsewhere. We now see many of these same tensions and market features in several US states, including Texas and California.

Returning to the Sunshine State, the result of this evolution today is a dysfunctional insurance market contoured by a byzantine architecture of public and private institutions. Notable consumer underwriters include Citizens (a state-run "insurer of last resort") and private "specialist" insurers that focus most of their business in Florida. Due to the concentrated insured property value on their books, many Florida insurers are especially dependent on external capital to de-risk their business.

Assetizing Property Catastrophe Risks

Enter reinsurance, or insurance for insurers. Today, a large share of Florida-bound reinsurance capital is raised through insurance-linked securities (or ILS) and similar forms of investor-collateralized risk finance. Both ILS and traditional reinsurance protect local insurers in situations where they must make a big payout but would be unable to do so with their own capital—like a major Miami hurricane landfall. One risk modelling firm projected that such a storm could lead to $200 billion of residential insured losses – that is, not counting commercial damage or uninsured losses, like a drop in economic productivity. Such a storm would likely decimate local insurers. Hence the turn to capital markets for extra claims-paying capital.

This is where ILS comes in, financing relatively high-loss, low-probability "tail events." Brokers issue securities on behalf of insurers or reinsurers. These securities are backed by bundled insurance premiums held in a dedicated account—typically, offshored in locations like Bermuda. The proceeds from the sale of securities are also held in the account, acting as capital for that very rainy day. If an event (or series of events) lead to a pre-defined level of losses, the proceeds are sent to insurers to help pay claims. And if not, investors receive their initial capital, plus the policyholder premiums.

Repurposing the work of David Harvey, I conceptualize ILS as a real estate climate "risk fix"—one that satisfies those capital-hungry insurers that keep Florida's real estate markets liquid while also providing an outlet for footloose investor capital. In my analysis, I note that Florida insurers send about half of every premium dollar they collect from policyholders onward to reinsurers, in exchange for this crucial catastrophe finance capacity—much of which comes from ILS.

The growing importance of reinsurance and special tools like ILS in Florida underscores just how entwined our residential insurance markets are with global capital markets. And this is true for many "peak peril" catastrophe insurance markets, be it Texas and California or Japan and Australia. Transnational reinsurance markets are highly interdependent, with a handful of networked firms bridging geographies of risk (like Florida) with those of capital (like London or Singapore). ILS and similar reinsurance products are marketed to investors as a risk diversification strategy, as catastrophe losses aren't correlated with the ups and downs of the "real" economy.

The risk appetite of these capital providers is not infinite, however. Aggregated global catastrophe losses drain the pool of capital available to finance disaster risk in Florida and similarly risk-exposed places. In a climate-changing world, this raises questions about just how durable this risk financing system will be over a longer horizon.

The Re-Risking State

This complex architecture of risk finance wouldn't exist without an extensive bricolage of state-level public institution supports—what might be conceptualized as a *re-risking state* at work. This concept extends Daniela Gabor's notion of the de-risking state: that is, an arrangement of state mechanisms, like subsides, which grease the roll-out of private finance strategies for collective goods, be it clean energy or climate adaptation infrastructure. Here, we see public mechanisms at work to de-risk the entry of risk capital into the insurance system, with the aim of stabilizing the market—and Florida's property state more broadly. But this influx of capital does little to materially reduce risk. On the contrary, it facilitates sustained asset value growth and new development, thereby *re*-risking the state's fortunes in the long run.

Techniques of re-risking can be seen in the myriad ways the state enables the use of ILS. The state normalizes the conditions under which private insurers turn to ILS by, for example, assessing insurers' claims-paying abilities under various catastrophe stress tests. Stress tests have been used to nudge insurers to purchase additional risk financing capacity from international markets, and more generally serve to codify private, external risk finance's role within the state's insurance system.

Moreover, the state directly and indirectly feeds risk to risk finance markets, including ILS investors. Directly, the state has become a major buyer of private reinsurance and ILS. The state-run Citizens is among the world's largest direct issuers of ILS. Citizen's $1.5 billion *Everglades Re* placement in 2014 stands as the industry's single largest issuance. Indirectly, the state also encourages private insurers to adopt policies from Citizens—many of whom in turn pass this risk over to reinsurers and specialist funds. Some Florida insurers off-sell risks to ILS funds for commissions—an example of what Leigh Johnson has called "underwriting to securitize."

Florida public policymaking and state-run institutions prop up these speculative risk financing activities in several additional ways. The state pension has allocated 1% of its portfolio to ILS markets. And a broader institutional architecture of de-risking—including a state-owned reinsurer and a public guarantor—work to stabilize the conditions for risk capital to flow through the mortgaged corners of Florida's housing market.

Rethinking Risk Finance

State policymakers' bets on ILS may appear logical if one assumes endless property development and asset inflation in high-risk regions is sustainable, or that transnational reinsurance markets can continuously finance these growing risks at prices affordable to homeowners and other consumers. In other words, this approach momentarily soothes—rather than fundamentally reckons with—the underlying drivers of the state's insurability crisis.

As Paula Jarzabkowski and colleagues have argued, these and other limitations within existent insurance strategies will require new and reimagined risk management institutions—including what they call "protection gap entities." Looking ahead, a key challenge, then, will be to understand how intersecting and varied insurance, housing and climate vulnerabilities look on the ground in frontline neighborhoods and regions. More attention will need to be paid to how shifting protection gaps can be more thoroughly addressed through a range of integrated interventions—from new forms of insurance and more expansive building retrofitting to renewed spatial planning and climate-robust infrastructure provision. Most importantly, continued decarbonization is needed to lessen the severity of climate change—the most fundamental source of "risk" in housing. This requires a renewed public purpose for insurance-based risk finance, one that focuses on reducing underlying harms and securing safe and equitable places to live in a climate changing world.