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In flood-prone Grand Isle, La., average annual insurance premiums have hit close to $11,000 a year. SEAN RAYFORD/ GETTY IMAGES

A 'Disaster Discount' Could Become Reality For Home Prices

Homes in the path of hurricanes and other natural disasters aren't much tougher to sell than those in calmer neighborhoods. Probably not for much longer. *

A "disaster discount" may be creeping into the U.S. housing market. According to real-estate brokerage Redfin, homes in areas that are vulnerable to floods, wildfires, and extreme heat are rising in value at a slower rate than low-risk properties.

The discount is still very small: Homes in areas that are prone to wildfires gained 6.4% on average over the 12 months through June 2024, underperforming low-risk homes by less than half a percentage point.

Vulnerable properties are still rising in value. And overbuilding in states such as Texas and Florida may be behind the underperformance, rather than worries about the weather.

But buyers will find it harder to turn a blind eye to the costs of protecting properties in some areas. Home-insurance providers are repricing risk after years of suffering heavy losses caused by natural disasters. Higher premiums also reflect the fact that a lot of building has happened in stormy parts of the country, so there is more value at risk.

According to estimates from climate- risk modeling company AlphaGeo, homeowners in California's Pacific Palisades, where thousands of homes were destroyed by wildfires earlier this month, can expect annual insurance premium increases of 11% for at least the next decade. New rules that will allow reinsurance costs—a form of cover for insurance companies—to be passed on to California customers in return for providing cover in fire-hazard areas will push up bills for homeowners.

In flood-prone Grand Isle, La., average annual insurance premiums have hit close to $11,000 a year, according to insure.com, an insurance comparison website. Homes there are still rising in price, even with annual insurance bills now representing 5.7% of the $194,000 average home value in the area.

A property that is becoming a lot more expensive to insure should carry a discount. Based on a net operating income analysis, an asset- valuation tool used by real-estate investors, climate-risk modeling company First Street Foundation found that a jump in the cost of homeowners insurance from $1,400 to $3,200 a year could theoretically devalue a $296,000 home by 12%.

But it is difficult for ordinary buyers to understand how big of a haircut they should ask for. Even though premiums have risen sharply recently, regulations in some states still prevent insurers from fully pricing flood and fire risk. This suppresses useful price signals by keeping premiums artificially low and makes risky areas look safer than they are.

Costs also are being distributed through cross-subsidization. Some insurers offset losses in vulnerable areas by charging policyholders in safer neighborhoods more than is merited by the underlying risk. Clearer data about the true exposure of a property would help buyers to avoid overpaying and discourage developers from building in volatile parts of the country.

Flag?

Better disclosure rules are starting to give buyers more bargaining power. In California, homes in certain areas that had to flag hazardous wildfire risk in property deals sold for 4.3% less than nearby properties that faced no disclosure requirement, a 2023 study by the University of Kentucky found. Florida's new House Bill 1049 means sellers have had to flag flood risks to potential buyers since October of last year.

More transparency isn't good news for everyone. When Oregon updated its wildfire map recently, some homeowners were upset to find their properties now labeled high risk. Real-estate agents might not love greater disclosure either. "It does have the potential to kill sales if the information is unfavorable," said Jeremy Porter, head of climate implications at First Street.

Even with a full picture of a property's risk, it can be hard to ask for a discount when the housing market is as tight as it is now. In December, 3.3 months of existing home supply was available for sale based on the current monthly sales pace, according to the National Association of Realtors. Buyers don't normally have the power to negotiate on price until there is six months of supply or more to cherry-pick from.

But at least they are getting new tools to size up properties. Websites such as Zillow and Realtor. com have started to include cli--mate-risk data with sales listings. The screenings are basic, but buyers can use the information to spot problems at properties that might need further investigation.

Climate risk also will start to affect housing deals if mortgage providers start to incorporate more-aggressive forecasts of insurance costs in their payment-to-income tests.

Borrowers may find that a house that looks affordable today may not be for very long. Last summer, Freddie Mac said lenders must start using full-risk premiums when testing borrowers' affordability levels.

Already expensive, homeownership is becoming even less-affordable in parts of the country where insurance costs are rising fastest. As that reality sinks in, owners could have more trouble selling up.

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—*Carol Ryan*

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