A Dream Blown Away

Climate Change Already Has a Chilling Effect on Where Americans Can Build Their Homes

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A place near the water has been an American dream for a very long time. Fifty-four percent of Americans live within 50 miles of a coast.

This is the year, however, in which the big boys in global finance got religion about climate change. As a result, this American dream -- as far north as the Washington area, and even New York and New England -- is under attack.

Follow the money. Insurance doesn't sound like a world-changer. It seems so banal and prosaic, like reliable electricity or clean water.

Yet without it -- you want a place to live? You cannot get a mortgage without insurance.

You want a job? A commercial enterprise cannot run without insurance.

Never want a drink of water / Til the well runs dry. / Never miss a real good thing / Til he says good-bye.

Turns out you don't have to wait for the waves to lap around your ankles. The climate is changing, Lord knows exactly how fast. But the money is moving pretty quickly.

Call 2006 the Batten Down the Hatches Moment.

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When Peg and Ronald Buchanan left Silver Spring two years ago for retirement, they saw as their nest egg the house they'd built right on the ocean in the North Carolina Outer Banks.

It's a big place -- eight bedrooms, nine baths, three stories, 5,000 square feet, heated pool, kiddie pool, wild horses out back, dolphins out front. "It sits like a palace in the sky," Peg says. The front door is 12 feet above sea level. They figured on selling it for $2 million. The proceeds would pay for the rest of their lives.

Now they're wondering if they will ever be able to sell it. The map of their part of Carova Beach has been redrawn as a high-risk flood area by the Federal Emergency Management Agency. As a result, it may not be possible for any new buyer to get a mortgage.

Even on their existing loan, the Buchanans are having a hard time getting flood insurance. On a house that cost $700,000 to build and furnish, their lender has been able to get them only a $250,000 policy, with a $50,000 deductible.

The thought of losing their retirement reserve "really makes me mad," Peg says. "I feel like going over with a shotgun."

Emotion, however, does not drive insurance writers. By definition, they are the world's most serious futurists. When it comes to life insurance, for example, they pride themselves on their ability to routinely and accurately predict when a whole lot of people are going to die. If their models are wrong, and they have to pay out too much money too quickly, they go bankrupt.

As a result, these fiduciaries have a long and distinguished history of driving social change. Passion-laden causes move beyond the realm of hand-waving activists when large gray men in large gray suits decide they must.

Highway fatalities dropped when insurance companies started financially punishing unsafe drivers, as well as makers of unsafe cars. Cigarette smokers saw their life insurance premiums skyrocket.

The big buzz in the insurance industry today is climate change.

Lloyd's of London's June report is titled: "Climate Change: Adapt or Bust."

The 2005 hurricane season gave the United States supposedly once-in-a-century storms, one right after the other. Katrina, Rita and Wilma were among the seven most expensive hurricanes ever to hit the country. Companies that had to eat too much of the $51.5 billion in insured losses went under.

The big problem with climate change for the insurance companies is not the risk. Their whole business is getting paid to accept risks.

The trouble is that their traditional means of calculating what is an acceptable risk -- and how much to charge for it -- is based on history.

It assumes that tomorrow will pretty much behave like yesterday.

Now they think that when it comes to the weather, the world is moving.

Wind and flood seem to be playing by new rules.

Batten down the hatches.

Fear of Buying

When insurance companies refuse your trade, it's nothing personal. It's just business.

You can tell by the marvelously emotion-free language the industry uses: "Cat coverage," for example, is about catastrophe. "Wind" means hurricane. "Insufficient capacity" and "the market won't clear" refer to climate risks so difficult to calculate that traditional commercial providers won't sell you new insurance or renew your old insurance at any price.

At any price.

This spring, "astonishingly, the capital markets were full up on Florida wind," says Peter Nakada, managing director of RMS Consulting -- short for Risk Management Solutions, one of the industry's foremost risk modeling firms. "That capacity shut down in the frenzy prior to this wind season. People were scrambling to get coverage. That was brand-new. We saw the market saturate.

"People couldn't renew."

Some of those people facing insurance crises have a hard time understanding why.

"I feel sorry for Katrina victims -- it was a terrible thing," Peg Buchanan says. "But I don't see why the rest of the world should be punished because we like oceanfront."

Bill Hogan, with Twiddy & Co. Realtors in the Outer Banks, explains: "What's happened is that there is a stretch of land north of Corolla with no federally subsidized flood insurance. It's called, locally, the Four Wheel Drive Area. No hard-surface roads. It includes Swan Beach, North Swan Beach and Carova Beach. There are houses up there -- 14-bedroom oceanfronts -- for about $2 million," Hogan says. "Buy a lot for about a million. Build a house for about a million."

But then FEMA redrew the flood map. "All of a sudden, the lenders are requiring flood insurance where they did not in the past." The only source "for the kind of insurance the lender requires is somebody like Lloyd's of London. It might have a $50,000 deductible, and still be prohibitively expensive."

Hogan says he's now seeing "$100,000 lots plummeting in value. I don't know what they're worth. Nothing is selling. Buyers are afraid to buy. All kinds of rumors are flying around -- insurance companies are pulling out. The net effect is you bought property and it was in a good zone, and all of a sudden you sit there and it's deemed to be bad. Right now people are scrambling. Getting letters from banks -- 'We have no record of your flood insurance.' Just the kiss of death for the owner of the lot," Hogan says.

In Delaware, Westfield Insurance has canceled all coastal policies, and "we've been told that there are others who are starting to restrict their coastal writings next year -- bigger players in the market," says Michael Vild, deputy state insurance commissioner. He adds, plaintively, "There have never been hurricane-force winds in the state of Delaware in recorded weather history. We think companies restricting coastal coverage are overreacting. Although if we have a couple more years like 2005, it's going to be extremely difficult to get coverage."

There are 438,000 people living in low-lying Virginia Beach. It is marked by high-rise hotels smack on the water, without even dunes between the boardwalk and the surf.

In October, State Farm stopped writing new insurance on businesses within 2,500 feet of the ocean there. In November, Traveler's Insurance refused to sell or renew residential insurance there without a 3 percent hurricane deductible. On a $500,000 house -- no longer uncommon -- that means if you get hit by a hurricane, the first $15,000 comes out of your pocket.

In Ocean City, new construction has become formidably fortified. Almost all of the island is expected to be underwater in a major blow. But on the ocean side, which will take the brunt of a storm surge -- a wind-driven wall of a water -- local government requires homes to be built on pilings driven perhaps 20 feet into the ground, sticking up some seven feet. Sixteen-inch bolts then attach the beams on which the house is built to the pilings, and each floor joist is attached to the beams with steel straps. The walls and roof are then held onto the beams and each other with more steel.

"I don't know of any other jurisdiction in the state of Maryland that runs the hurricane system we run," says Mike Richardson, Ocean City's chief building official. It is designed to withstand sustained winds of 90 miles per hour with three-second gusts to 110.

Will such fortifications become common around Washington? "Katrina showed us that inland areas are susceptible to flooding," Richardson says. "We're not just talking about the ocean -- we're talking about Chesapeake Bay, talking about Deep Creek Lake flooding. The Potomac has flooded before. So has the James."

Dire Forecasts

So far, climate change has shaken the market most notably in high-value coastal areas. But if weather losses get worse, upheaval will become more common.

There is no question that the insurance industry is focused on how weather losses are getting worse.

In early September, when the leaders of the big European reinsurance companies had their annual gathering -- called the Rendez-Vous, in the posh principality of Monte Carlo -- one of the big discussion points was the gap between supply and demand for reinsurance in U.S. wind-affected areas, according to the industry journal, Reactions.

Reinsurers are the big boys who can throw around numbers with nine or 10 zeroes at the end and still sleep at night. They insure the insurers, buying risk beyond the appetite of ordinary companies. The most romanticized is Lloyd's of London. However, when Swiss Re and Munich Re talk, all conversation in the room ends until whatever is on their minds stops reverberating.

Today, what's on their mind is climate change.

"There are horror stories about the frequency and severity of hurricanes increasing," Reactions reported in September. That plus the skyrocketing number and value of properties on the U.S. coastline "has prompted many to question whether it is possible to write catastrophe business profitably."

At all.

"If you feel the price is not right, you pull out," matter-of-factly acknowledges Kurt Karl, head of economic research and consulting with Swiss Re in New York.

Since 1971, "Insured U.S. weather-related losses are growing 10 times faster than premiums and the overall economy," reports Ceres, a coalition whose observations get attention from the big boys in part because they've built a climate-risk network that includes 50 institutional investors managing more than $3 trillion.

Unacceptable Risk

Insurance companies approach climate change bracingly free of theory. They take only an academic interest in whether the wind blows because of increases in carbon dioxide in the atmosphere, or cyclical fluctuations in the Atlantic, or the huffing and puffing of the Big Bad Wolf.

They just want to calculate the odds. They want to know how many chips to put on the table.

And where.

"Two effects are going on," says Nakada, of the risk modeling firm RMS. "Hurricane activity rates have gone up." But also, "Hurricanes are perceived to be longer-lived. These longer-lived hurricanes have a better chance of sneaking up the coast. The view of vulnerability has changed."

The specter looms of the big hurricanes of 1938 and 1954. Those Category 3 hurricanes devastated New England. Storm surges of 13 and 12 feet, respectively, swept through Providence, R.I. Historic markers demonstrate how high the water rose downtown. They are over your head. Photos show seas crashing over the top of a harbor lighthouse. It is 70 feet tall. Beach homes were swept out to sea.

"Our view is that there are some events that have the potential to be so large as to exceed the capabilities of the insurance industry, as well as the funding and financing capability of individual states," says Michael Trevino, the spokesman for Allstate, one of the nation's largest home insurance companies. "Those are events that have the potential to be $100 billion. These events are so enormous, no entity has the ability to manage it."

Some require little imagination, such as a Category 4 hitting Miami or a Category 4 coming up the Houston Ship Channel aimed at the center of the U.S. oil industry, and America's fourth-largest city.

But the one Allstate is focused on is a Category 3 funneling straight north up New York Harbor. Pushing a wall of water perhaps 15 feet tall up Broadway toward the second-story windows of Wall Street.

This is why Allstate has decided not to write new homeowners insurance in the five boroughs of New York City -- Manhattan, Brooklyn, the Bronx, Queens and Staten Island -- plus Westchester County, just north of the city, and the counties that make up Long Island -- Nassau and Suffolk. In the most vulnerable parts of that market, they are also not renewing existing insurance.

"What we decided was that the total insured property values in New York State are about $1.9 trillion. We have a big share of the homes in that state" -- in the eight counties, Allstate's market share was 26 percent.

"Fundamentally, we've got enough exposure, thank you."

To Move or Not to Move

What does this mean for the future of beautiful areas around Washington near big bad bodies of water, from Duck to Rehoboth and from Alexandria to Annapolis?

"If you have a ton of money and don't mind paying three times the insurance as two years ago, you're probably happy," Nakada says. "There'll be all sorts of property available on the coast in warm weather places if the market gets more efficient."

But what about for the rest of us?

"In terms of affecting where people live and do business, three things have to happen: The risk has to go up a lot. And it just did. Number two, the market needs to allow that cost to be passed on to customers, or not. In which case, number three, either the price goes up, or the availability goes down in insurance.

"At that point you would think hard about whether you want to move."

Batten down the hatches.