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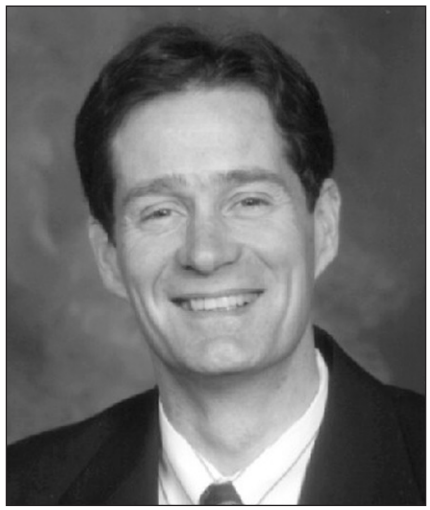
In Katrina's Wake, Insurance Debate Pits Wind Versus Water

By Geoffrey A. Gordon

HURRICANE KATRINA CONTINUES TO BE IN THE news a full year after the storm and the insurance angle remains among the lead stories. How insurance has responded to Katrina is instructive and worth examining to make us all better buyers of this complex, misunderstood and expensive product.

Home and business insurance pays for hurricane damage from wind, but not from flood water, which caused so much of the damage last fall. In New Orleans Parish, with approximately 215,000 housing units, only 85,000 flood insurance policies were in force when Katrina came ashore, according to a Reuters report. The absence of flood from other insurance coverages has slowed recovery and left many property owners without insurance assistance in the wake of this enormous disaster. This dichotomy illustrates a fundamental feature of insurance, and is too important to ignore.

Why does the industry separate flood from all other insurable property-related events? For years, home and business property insurance has excluded damage from "flood" and groundwater for two reasons. First, flood is not considered an insurable risk for private companies. When flood damage occurs, losses can be so expensive and concentrated that individual companies cannot provide coverage without putting their own financial survival at risk. In 1968 the National Flood Insurance Program (NFIP) was created to provide an insurance market for this unique and relatively predictable hazard. Secondly, damage from floods is much more predictable than all the other things that can go wrong for which we buy insurance. Nobody expects a fire in their home but experience tells us that floods happen with some regularity in certain places, and never in others. Thus many people don't need flood coverage at all; others know they'll need it. The NFIP has detailed maps showing flood zones based on the historical frequency and severity of floods. The frequency of flood damage in Zones A (usually first-row, beach-front properties) and V (usually, but not always, properties near water) is some six times as likely as a fire over a 30-year mortgage time period. Thus, people who need flood coverage buy it separately.



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Enter Hurricane Katrina, whose storm surge pushed 15 to 30 feet of water over areas of Mississippi, Alabama and Louisiana, and not just on the coast but for miles inland. Images of the damage caused by flood water still appear regularly on the news, but even these don't adequately show the broader damage caused by subsequent rot, abandonment and ongoing degradation.

A storm surge brings tides way above normal high tides, caused by the push of high winds of big storms and pull of low barometric pressure. A surge is measured in feet above normal mean tide. A 20-foot surge means that the tide itself is 20 feet above normal tides. Add wind-driven waves and two high tides every day. One cubic yard of water weighs over 1,600 pounds, so strong waves pack a real punch. When a hurricane comes calling, the coast at landfall is pretty much guaranteed to get at least one high tide during the storm's greatest period of intensity, plus the surge. Hurricane Opal hit Pensacola in 1995, producing a 20-foot surge; Hugo came to South Carolina's coast with a 19.8-foot surge and Katrina produced a 30' surge in Bay St Louis, Miss. Storm surges are real; it's only a question of landfall.

Predictable Losses

So, back to the Gulf, and how this separation of coverages is being resolved. This is where we see the lawyers and other opportunists enter, decrying the insurance companies' failure to pay claims by citing this "flood exclusion." While there are plenty of legitimate cases where damage from both wind and flood exist and real disputes exist in quantifying damage from each, the industry is concerned (and consumers should be, as well) about lawsuits demanding that private insurers pay for damage from flood. We've all heard the arguments that the insurance companies have so much money, they should pay their fair share; and, of course, that people have been paying in for years and now they're being turned down by their insurer when they most need help. These populist arguments feed the public's mistrust and debase the dialogue. Instead of trying to extort insurance companies and their shareholders' assets for which premiums were never collected, and where coverage was readily available on a subsidized basis, we

continued on page 2

should be asking why so many people choose not to buy insurance for such a predictable loss.

First, though, it is worthwhile to look at how these lawsuits are being settled. In the first major suit to be decided, famed tobacco lawyer Dickie Scruggs argued that the water that came ashore was "wind driven," and therefore damage resulting from that water should be covered. The suit was denied by U.S. District Judge L.T. Senter Jr. in August, when he ruled that wind-driven water was still flood water. More recently, Mississippi's attorney general, Jim Hood, joined the fray, making similar claims that effectively would rewrite policies retroactively to provide flood coverage. If these lawsuits settle requiring insurance companies pay flood claims (remember, flood coverage has been available through the NFIP), insurance companies will be forced to abandon an already-troubled market. Independent companies cannot long be forced to give away coverage for which they have received no premium before altering market tactics. The last thing this region needs is an abandonment of insurance availability, as people try to rebuild. Banks need to know insurance is protecting their collateral, and insurance companies need to know that their contracts are valid.

Neither is government largesse the answer to this broad damage. Federal spending on Katrina relief has been five times any other natural disaster in the past 50 years and almost 10 times the total federal assistance for all 2004's hurricanes or the Northridge earthquake. Many residents and property owners have simply moved away, anxious over the prospect of rebuilding again, leaving abandoned properties across the Gulf Coast.

The question is important here in New England, as well, because potential flood conditions exist in many of our coastal communities, where population density and coastal development has surged. Buzzards Bay and Narragansett Bay in particular are subject to powerful surges from northward-traveling hurricanes due in part to their conical geography, shallow underwater slope and relatively flat inland coast. Naturally Barnstable (Cape Cod) and Dukes (Nantucket and Martha's Vineyard) counties face their own threats, and Plymouth and Essex counties also face potentially extreme damage under the right storm path (the "left hook"). Katrina progressed 90 miles inland as a Category 2 hurricane; Cape Cod is less than 6 miles wide through most of its midsection.

Why people don't buy insurance for such a predictable hazard has plenty to do with the fact that no major storms have visited New England in most residents' lifetimes. But the past three decades are not reliable predictors. Consider how insurance companies have braced themselves for major weather events over the past few years (see my related article in the May 20, 2006, issue of Banker & Tradesman). Nor are floods limited to the coast. Last spring we saw floods in Massachusetts and southern New Hampshire where floods had never occurred. If you are within a few miles of the coast, the question to ask is, do I have anything I wouldn't want sitting in salt water within 15-20 feet of the high tide mark? Ultimately the price, availability and broad purchase of flood insurance is critical to a healthy and sustainable coastal real estate market. ■