MOODY'S

ANALYSIS

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Assessing the Impact of Homeowners Insurance on House Prices and Affordability

We focus on the rising cost of homeowners insurance in this study. We begin by summarizing information on average annual insurance premiums. This information has been added recently to the Moody's Analytics historical database at the national, state and metro levels. Next, we consider the relationship between insurance premiums and house prices at varying levels of geographies. From there, we turn our focus to affordability. We propose a more comprehensive measure of affordability that considers not only monthly mortgage expenses but also insurance premiums, property taxes, and ongoing maintenance and repair expenses. We examine the predictive power of this measure as it correlates to house prices. We conclude our study with a discussion of future trends and expectations for house prices and affordability given expectations for rising insurance costs.

Assessing the Impact of Homeowners Insurance on House Prices and Affordability

BY CRISTIAN DERITIS

Rising housing costs are taking up an increasing share of U.S. household balance sheets. According to the latest Moody's Analytics analysis, renter households now spend an average of 26.8% of their income on rent with metro areas such as New York closer to 57%. Homeowners benefited from the sharp decline in mortgage interest rates in 2020 and 2021 by refinancing their mortgages and locking in record-low interest rates. Although this reduced their monthly debt expenses considerably, other housing-related expenses have increased, including homeowners insurance and property taxes. The impact of these increases is felt most acutely by first-time homebuyers who face mortgage rates above 7% in addition to these other housing costs.

We focus on the rising cost of homeowners insurance in this study. We begin by summarizing information on average annual insurance premiums. This information has been added recently to the Moody's Analytics historical database at the national, state and metro levels[1]. Next, we consider the relationship between insurance premiums and house prices at varying levels of geographies. From there, we turn our focus to affordability. We propose a more comprehensive measure of affordability that considers not only monthly mortgage expenses but also insurance premiums, property taxes, and ongoing maintenance and repair expenses. We examine the predictive power of this measure as it correlates to house prices. We conclude our study with a discussion of future trends and expectations for house prices and affordability given expectations for rising insurance costs.

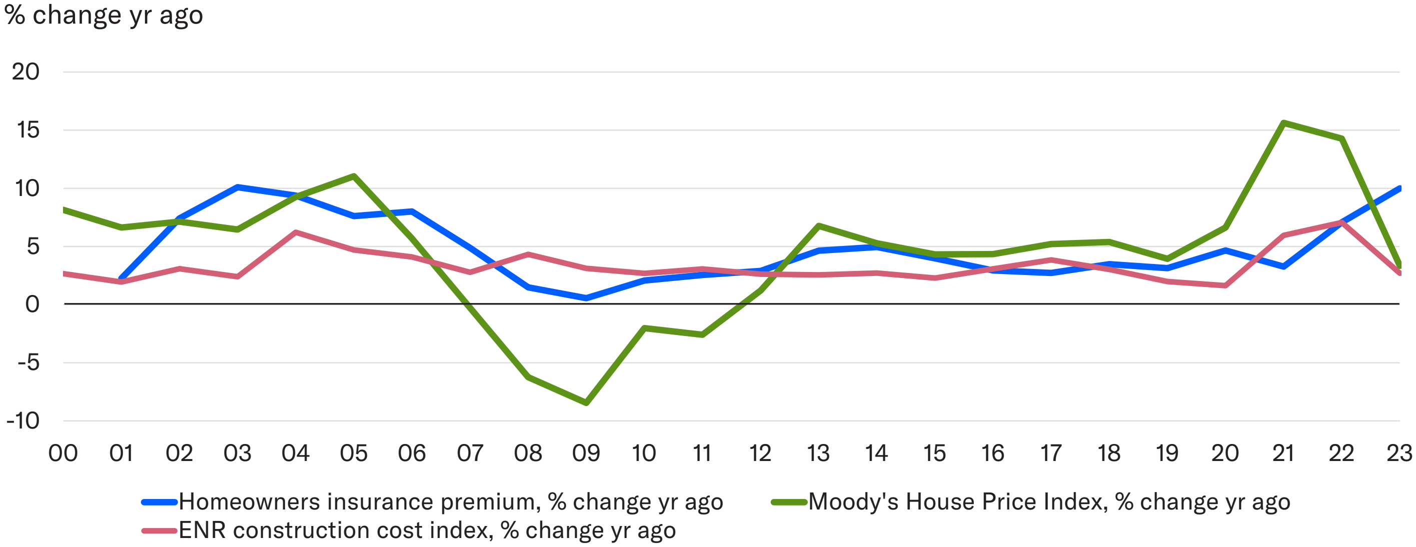
HOMEOWNERS INSURANCE PREMIUMS ACCELERATE

Historically, homeowners have sought to insure their properties from casualties such as fires or storms given their exposure to both the direct replacement costs and the indirect costs resulting from loss of use. Moreover, homeowners insurance is a mandatory requirement for owners with mortgages. This is to protect lenders from potential losses. Indeed, borrowers who fail to maintain coverage on their properties may have insurance "force placed" by their lenders with the premium cost added to the borrowers' outstanding debt. For this reason, mortgage loan servicers often require monthly escrow payments from borrowers to ensure there are sufficient funds available to pay both annual homeowners insurance premiums and property tax assessments.

Prior to 2019, insurance premiums rose 4.5% annually on average, based on the American Community Survey. This was roughly in line with house prices and the annual increase in construction costs (see Chart 1). From 2020 to 2022, house price appreciation far outpaced the growth in insurance premiums because of lags in insurance assessments (homeowners insurance premiums are typically paid in advance for coverage over the following year). In addition, state insurance regulators may impose caps on the amount by which insurance premiums can rise from year to year. As a result, it may take insurance premiums several years to catch up with their true costs. Data from 2023 are consistent with this observation; annual premiums continued to grow at an accelerated pace even as house price growth decelerated (see Chart 2).

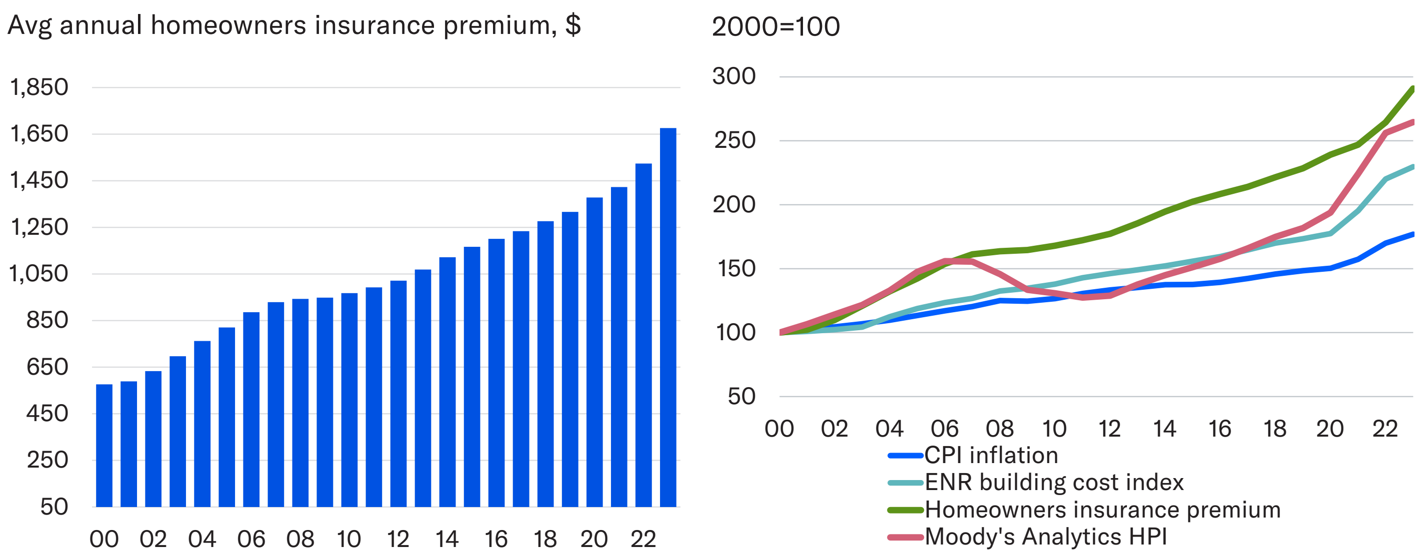
1 Subscribers can access the data at DataBuffet.com with the mnemonic INLHOPRMUA.<geo>

Chart 1: Growth of Homeowners Insurance Premiums Accelerating



Sources: Census Bureau, Engineering News Record (ENR) (McGraw-Hill), Moody's Analytics

Chart 2: Homeowners Insurance Has Risen Faster Than Inflation or House Prices

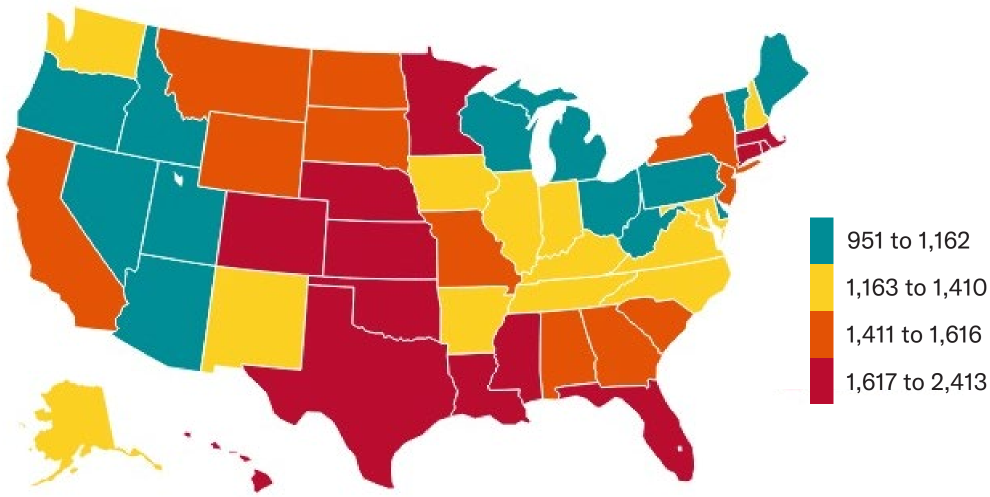


Sources: ACS/Census Bureau, Engineering News Record (ENR) (McGraw-Hill), Moody's Analytics

While inflation has pushed up the prices of building materials and labor shortages have increased construction worker wages across the board, insurance premiums vary considerably across geographic markets (see Chart 3). Average annual premiums tend to be higher in states with higher exposure to natural disasters (such as hurricanes in Florida and the Gulf Coast or wind and hailstorms in the Plains states). Higher housing costs have also driven premiums higher in some markets in the Northeast.

Chart 3: Homeowners Insurance Premiums Vary Considerably by State...

Avg annual homeowners insurance premium, $



Sources: Census Bureau, Moody's Analytics

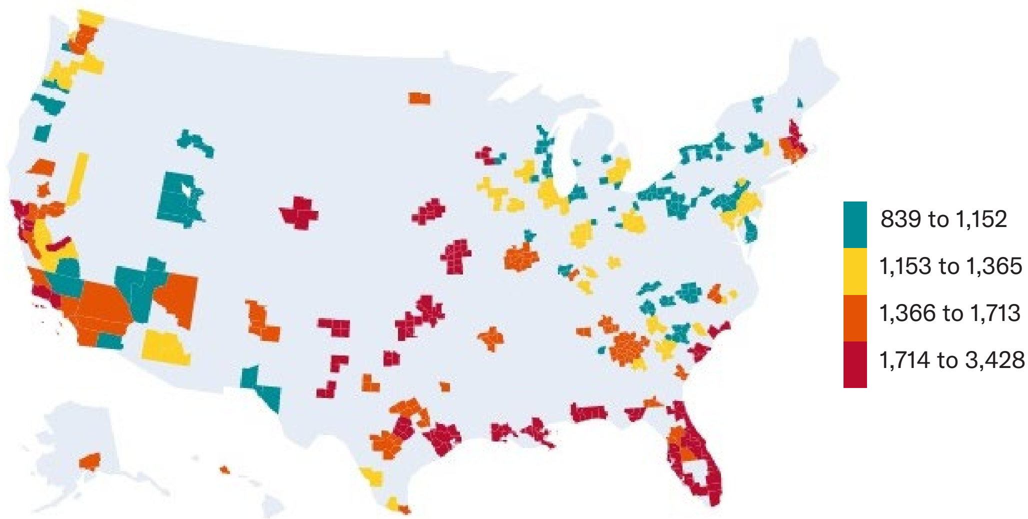
An obvious exception to these observations is California, which is characterized by a combination of some of the highest house prices in the nation and elevated exposure to natural disasters, including wildfires. The discrepancy between house prices and insurance premiums is largely caused by regulations that limit the premiums that insurers can charge. Given the rising cost of insurance claims in the state, a number of insurers have exited the California market entirely in recent years, because the premiums companies can collect are insufficient to cover potential losses from a large, negative event.

Florida is in a comparable situation due to the rising frequency and severity of hurricanes it has experienced over the last 20 years. The state-sponsored Citizens Insurance company now covers nearly 20% of all Floridian homeowners given the steady exodus of private insurers from the market. While increasing replacement costs have driven much of the rise in premiums, litigation and abuse of legal loopholes have contributed equally to premium increases. A prime example is "assignment of benefits," which allows homeowners to transfer their insurance claims to third parties such as roofers, plumbers, or other home construction companies. The stated intent here is to free homeowners from the bureaucratic burden of filing insurance claims and allow insurers to negotiate directly with construction companies that are more informed on the full cost and scale of repair projects. However, abuses have arisen with unscrupulous companies inflating the cost of projects for which they have been assigned benefits. Insurers that either pay these claims directly or contest them in court end up facing higher costs that ultimately get passed along to all homeowners. The Florida legislature passed a law restricting the assignment of benefits in late 2022 with the intent of curbing the growth rate of insurance premiums in the state.

Variations in premiums become even more apparent when we drill down to the metropolitan or county level (see Chart 4). The highest premiums in the country are in high-risk, high-cost areas of Florida and hurricane-prone areas along the Gulf Coast. The barrier islands off the coast of Louisiana have some of the highest premiums as a share of median property value because of their exposure to high tides and gale-force winds. At the other extreme, premiums in Hawaii are among the lowest despite the high cost of housing. Notwithstanding

Chart 4: ...And Even More by Metro Area

Avg annual homeowners insurance premium, $



Sources: Census Bureau, Moody's Analytics

its volcanic topography, Hawaii has traditionally suffered relatively few natural disasters. The recent, tragic Maui Wildfire is a notable exception that may push premiums in the state higher in future years.

INSURANCE PREMIUMS AND HOUSE PRICES GO HAND IN HAND

Turning our attention to the relationship between the cost of homeowners insurance and house prices, there are two effects to consider. First, higher house prices are correlated with higher insurance premiums. We can decompose house prices into the cost of land and the cost of the structure built on top of it. With buildable land increasingly in short supply in many real estate markets and with the price of building materials rising because of deglobalization, tariffs, increased regulation, and tight supply chains, it is reasonable to expect that insurance premiums and house prices would rise together.

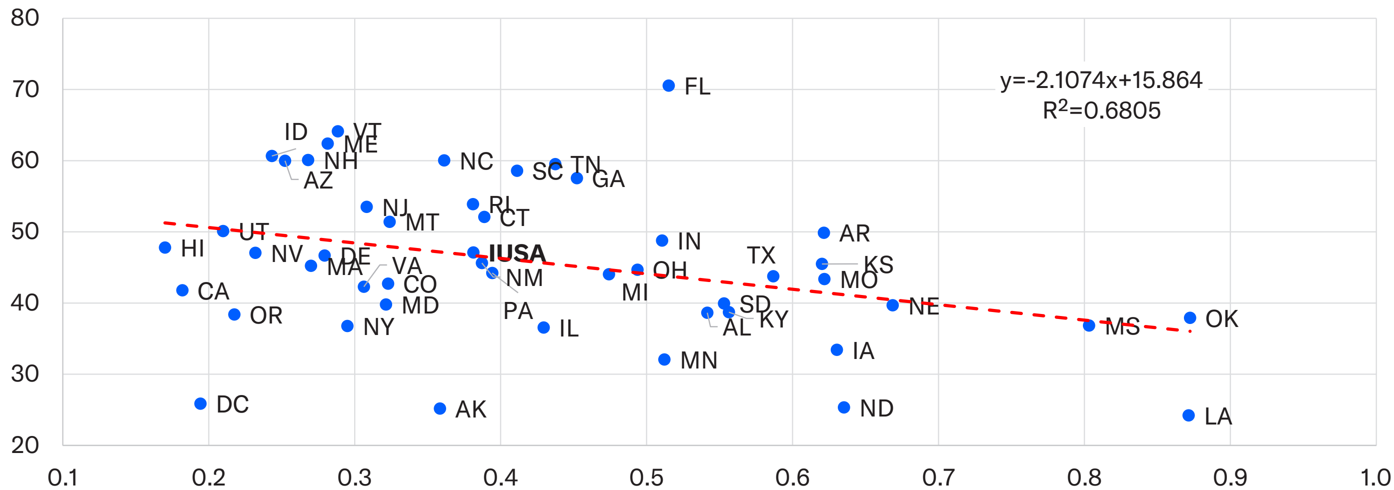
Upon closer inspection, we find that peaks in insurance premium growth tend to follow peaks in house price appreciation with a four- to six-quarter lag. Lags can vary by geography given variations in the regulations governing rate premiums across states. For example, some areas may place few limits on annual rate increases, allowing premiums to adjust relatively quickly as both the likelihood and severity of potential claims shifts. Other states are more prescriptive regarding caps on insurance premiums and forward-looking risk assessments leading to longer cycles of price adjustment.

The second factor to consider is that rising home insurance premiums can create negative feedback on house prices. As premiums rise, the total cost of homeownership also increases, limiting the eligible pool of buyers within a given market and putting downward pressure on both demand and house prices. Existing homeowners are not immune from these effects and may opt to sell and relocate if the cost of insurance should rise to unaffordable levels. The increased supply of homes for sale would put additional downward pressure on prices.

Consistent with this hypothesis, we find that states with higher insurance rates experienced weaker house price growth on average from 2019 to 2023 than areas where premiums were a smaller share of house prices (see Chart 5).

Chart 5: House Prices Grow More Slowly in Areas With Higher Insurance Rates

X-axis: homeowners insurance premium, % of house price; y-axis: Moody's Analytics HPI, % change from 2019



Sources: Census Bureau, Moody's Analytics

RISING INSURANCE PREMIUMS WEIGH ON AFFORDABILITY

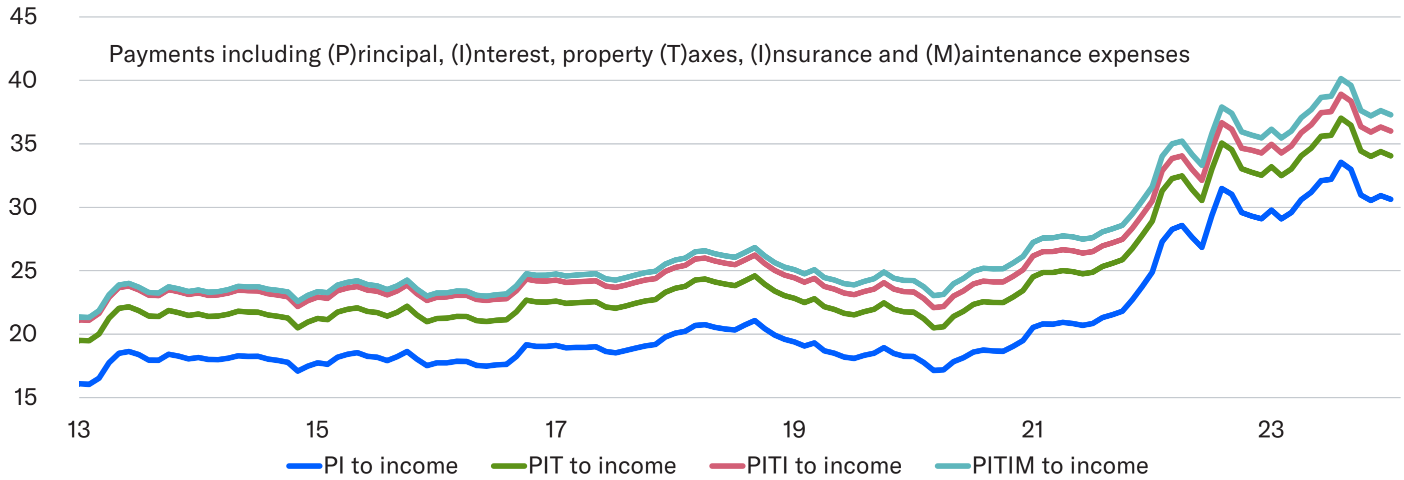
Although the data suggest a strong relationship between homeowners insurance premiums and house prices, they do not necessarily support a strong causal link. For example, Naples FL experienced both a sharp rise in home insurance premiums and house prices in recent years but also saw an increase in overall area median income and wealth as more affluent individuals moved to the metro area. Given the financial means of these homeowners, higher house prices may not be at risk of correction even with higher insurance premiums.

This suggests a more direct causal factor through affordability. Areas that experience a significant increase in house prices without an associated increase in income or financial wealth may be more at risk of a slowing or outright decline in house price growth. The additional burden of rising homeowners insurance premiums may hasten this process or even lead to a house price correction if the premium increases are substantial.

To better understand these dynamics, we created a more comprehensive measure of housing affordability than traditional measures that compare household incomes to the amount of income needed to qualify for a mortgage on a typical house at the prevailing 30-year mortgage rate assuming a 20% down payment. Instead, we assume that the typical homebuyer today provides a 10% down payment and pays a monthly mortgage insurance fee. Our affordability measure also includes estimates for monthly property taxes and insurance premiums. In April, our measure indicated that median-income homebuyers spend more than 36% of their incomes to cover housing expenses (see Chart 6). Although down from 40% in October, when interest rates briefly touched 8%, affordability is substantially more constrained compared with the pre-pandemic era.

Chart 6: Housing Costs Add to Financial Burden for Homebuyers

Monthly payment share of family income, %

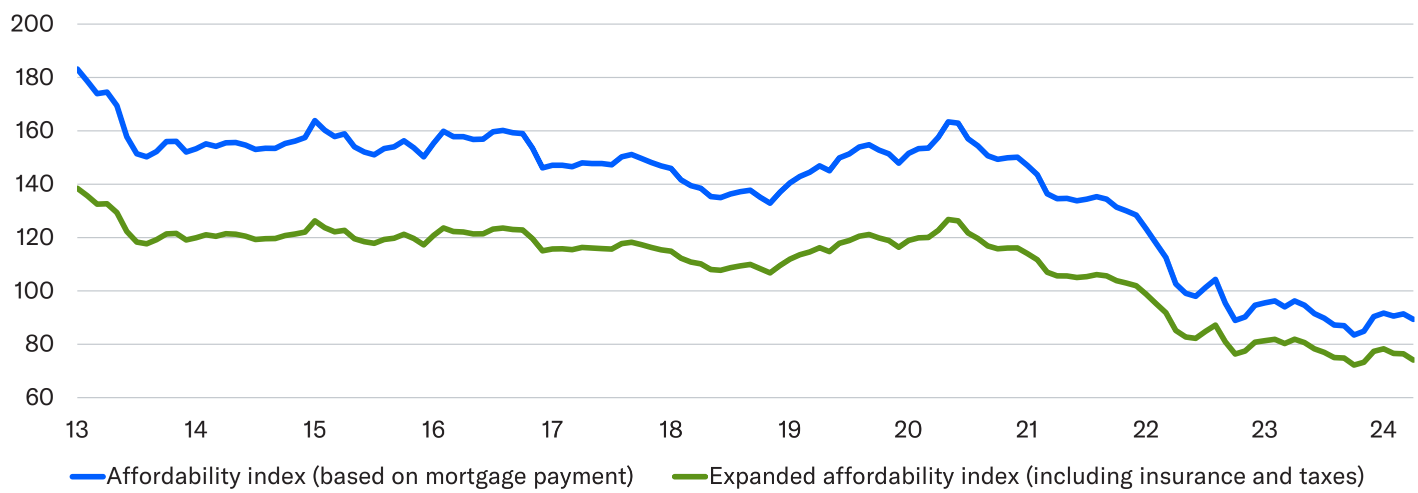


Sources: Census Bureau, NAR, Moody's Analytics

Traditional housing affordability measures compare median household or family income to the income needed to qualify for a mortgage with a 25% (or 28%) mortgage payment-to-income ratio. We expand this definition to include insurance and property tax expenses to provide a more comprehensive measure of the cost of homeownership. Based on this calculation, our "expanded affordability index" reported a value of 74 in April, suggesting that a homebuyer purchasing a median-priced home would need to earn 1.35 times the median household income to maintain a 28% debt ratio (see Chart 7).

Chart 7: Homebuyers Need 1.3x Median Income to Buy a Home Affordably

Affordability index=median family income/(qualifying income for 90 LTV loan with 28% payment ratio)

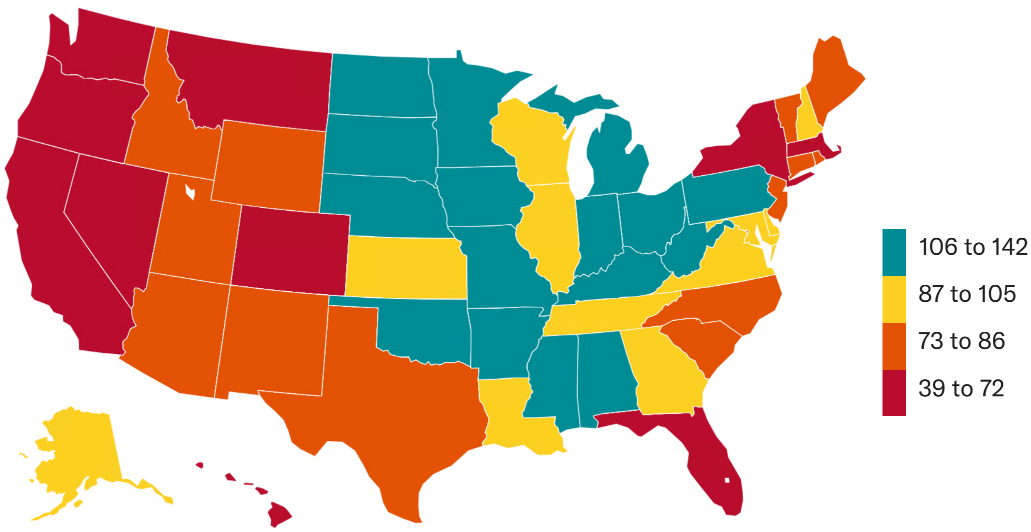


Source: Moody's Analytics

Using regional data on income, house prices, insurance and property taxes, we compute the expanded affordability index by state. Chart 8 highlights the affordability challenges plaguing Hawaii, Florida, the West Coast, and the Mountain West. Although house prices have risen across the country, midwestern states offer some of the best values for aspiring homebuyers. Families earning the median income in these communities can still afford the housing costs associated with median-priced homes if they can find a home available for sale.

Chart 8: Affordability Highest in Midwest, Lowest in West

Expanded affordability index including principal, interest, taxes and insurance



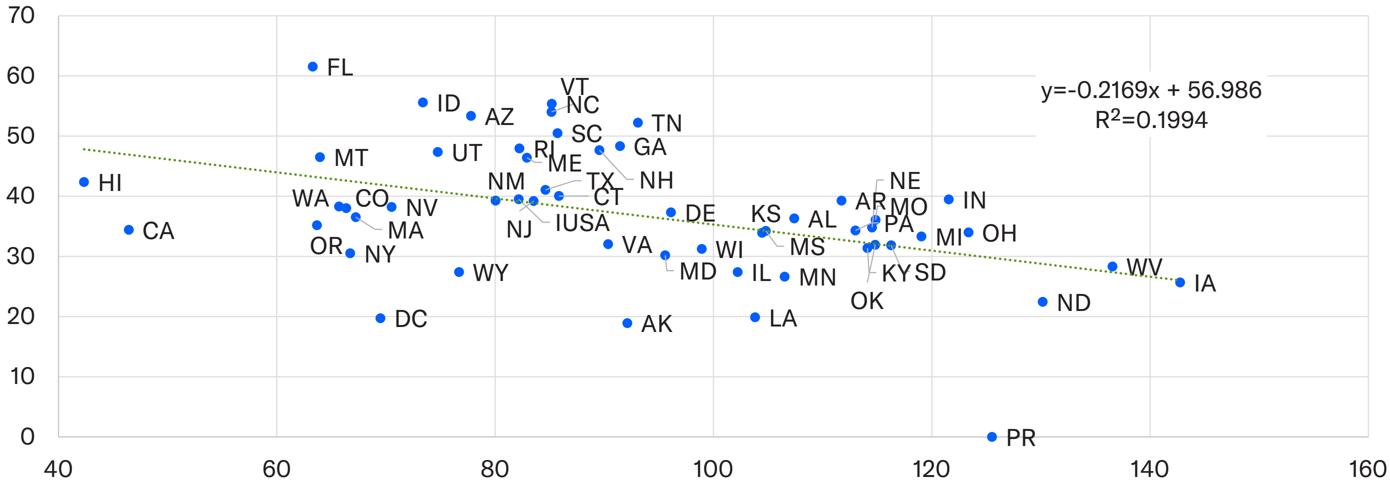
Source: Moody's Analytics

The relationship between affordability and house price growth is endogenous, as illustrated in Chart 9. That is, more affordable areas have tended to experience lower levels of house price growth than more unaffordable areas. A simple regression of affordability on house prices at the state level suggests that a 10-point gain in affordability is associated with house price appreciation that is 2.2 percentage points lower since 2019. While meaningful, some context is needed. Overall house price appreciation averaged just less than 50% from the end of 2019 to the beginning of 2024. Areas that were 10 percentage points more affordable still averaged gains of more than 40% in house price growth over this time. For context, appreciation before the pandemic, from 2015 to 2019, averaged 25%.

We find a similar negative relationship between affordability and homeowners insurance premiums, but here the relationship is weaker (see Chart 10). In some communities, price-sensitive buyers may be willing to accept a higher insurance payment in exchange for a lower house price and mortgage payment. Lower-priced homes may be in areas that are more prone to casualties such as flooding or storms because of both market dynamics and the legacy of redlining. Homeowners in these areas run the risk that insurance premiums may rise in the future as insurers reassess their risk of losses. In these cases, the total cost of homeownership may be appreciably higher than what is captured by mortgage principal and interest payments.

Chart 9: More Affordable Areas Have Slower House Price Growth

X-axis: affordability index; y-axis: Moody's HPI, % change from 2019



Sources: Census Bureau, Moody's Analytics

Given the rising cost of homeowners insurance and property taxes, Moody's Analytics intends to incorporate these costs directly into its house price forecasting models to provide users with a more comprehensive view of how the costs facing homeowners will affect prices in the future. Furthermore, adding these measures to the Scenario Studio platform will allow for expanded scenario analysis, permitting risk modelers to vary assumptions on the rising cost of insurance in certain jurisdictions to assess the long-run impact on house prices and other economic indicators.

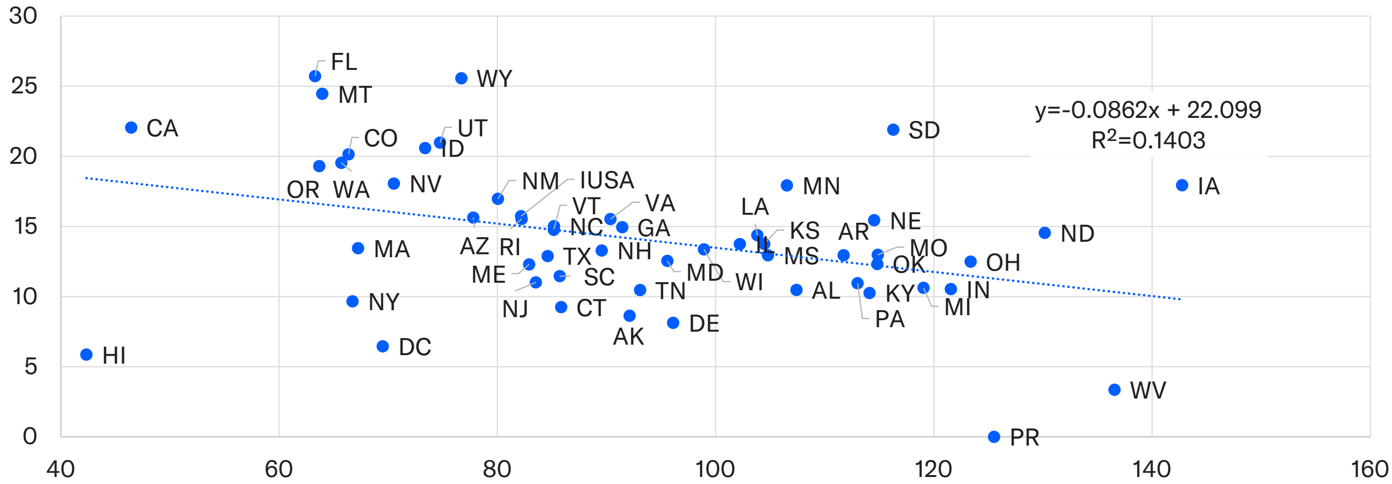
PARTING THOUGHTS

Shifts in the perception and cost of risk have a material and growing impact on the housing market and buyers' decisions today. The rising cost of homeowners insurance is now regularly featured in media reports and is a growing concern of state and local governments faced with the exodus of insurance companies from their areas. Stopgap measures including state-sponsored casualty insurance have averted catastrophe so far, but these measures come at a rising cost. A particularly severe hurricane, wildfire or tornado season could see the departure of even more insurers from certain markets, pushing the cost of insurance even higher. Businesses and households may already be avoiding certain geographies and preferring others as they consider their total costs.

Prices in the housing market have yet to fully reflect these rising expenses, but the day of reckoning is likely coming. Low mortgage interest rates along with lags in the repricing of insurance and the reassessment of property taxes have depressed monthly out-of-pocket expenses for families that bought homes at the height of the pandemic. However, these dynamics are quickly shifting as mortgage rates have risen and as insurance premiums and property tax bills have continued to increase.

Chart 10: Insurance Premium Growth Is Slower in More-Affordable Areas

X-axis: affordability index; y-axis: homeowners insurance, % change since 2019



Sources: Census Bureau, Moody's Analytics

Lenders, mortgage investors and policymakers need to pay close attention to these costs as they set their credit policies and forecast losses. The historical record may be of limited value for inferring future performance given how quickly insurance premiums are rising. The insurance premium information collected by Moody's Analytics provides a comprehensive summary down to metropolitan statistical area and county levels. These data can assist risk managers in the modeling of mortgage credit risk and permit other businesses to consider the impact on their revenues and profits should insurance costs continue to climb. As the insurance data continue to be supplemented and enhanced with other sources, users will be able to track and model the impact that rising premiums may have on their risk exposures and take corrective and mitigating actions as needed.

ABOUT THE AUTHOR

Cristian deRitis is a managing director and deputy chief economist at Moody's Analytics, where he leads a team of economic analysts and develops econometric models for a wide variety of clients. His regular analysis and commentary on consumer credit, policy and the broader economy appear on the firm's Economic View web site and in other publications. He is regularly quoted in publications such as The Wall Street Journal for his views on the economy and consumer credit markets. Currently he is spearheading efforts to develop alternative sources of data to measure economic activity more accurately than traditional sources of data.

Before joining Moody's Analytics, Cristian worked for Fannie Mae and taught at Johns Hopkins University. He received his PhD in economics from Johns Hopkins University and is named on two U.S. patents for credit modeling techniques.

About Moody's Analytics

In an increasingly interconnected and complex operating environment, organizations face challenges decoding the intricacies of the global economy. Moody's Analytics Economics team delivers timely and in-depth data, forecasts and analysis of the global economy's latest developments and trends—empowering organizations and policymakers to identify and manage risks, seize new growth opportunities, respond to geopolitical threats, and thrive in an ever-evolving landscape.

The Economics team has more than 35 years of dedicated experience in economic forecasting and research. Leveraging our team's global coverage and local expertise, our economists provide unrivalled insight on pivotal economic topics, including labor markets, housing and consumer spending, among others, across the Americas, Europe, the Middle East, and APAC. We also provide real-time monitoring of economic indicators, scenario analysis, and thought leadership on critical themes such as monetary and fiscal policy and sovereign risk—all of which support decision makers and policymakers in strategic planning, product and sales forecasting, stress testing, credit risk management, and investment decisions.

By combining economic modeling, expansive data resources, and innovative technology solutions, we equip business leaders with critical insights to navigate the complexities of an ever-changing economic landscape. Recognized for our industry-leading solutions and commitment to quality, client service, and integrity, more than 1,000 organizations worldwide—including multinational corporations, governments, financial institutions, real estate firms, and professional investors—trust us to help them turn today's risks into tomorrow's opportunities.

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