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Who Should Pay Homeowners Living in Dangerous Places?

By **Liam Plevin**
 From [The Wall Street Journal Online](#)

PALM BEACH, Fla. -- Hurricane season is over, but for John Beach there's one more financial cloud on the horizon. He recently got a notice that insuring the house he owns near the Atlantic Ocean against wind damage will cost \$7,606 in premiums this year, with a \$12,500 deductible. And he's in no position to shop around. The only company offering a policy is Citizens Property Insurance Corp., Florida's insurer-of-last-resort.

"I suppose we'll go ahead and pay it," says Mr. Beach.

He could soon be paying significantly more. Citizens is in a financial pinch, with a deficit in 2005 that could hit \$1 billion or more. The state begins hearings today to consider huge premium increases, and Citizens policyholders in Palm Beach County could see premiums increase nearly 40% or more if they are approved. In part of the Florida Panhandle along the Gulf Coast, premiums could rise by nearly 130%.

The hearings will offer a window into the increasingly complex economics of insuring homeowners in disaster-prone places, and they have implications that go far beyond Florida. At least 30 insurers-of-last-resort operate across the U.S., covering risks such as wildfires out West, ice storms in the Northeast and notably, hurricanes on the Gulf and Atlantic coasts. Some of the

"Bluntly, the coast can't afford itself," says Jim Oliver, general manager of the Texas Wind Storm Association, and association's pool of residential policyholders has grown from 68,756 at the end of 2001 to 99,246 at the end of 2005, expected to top \$130 million.

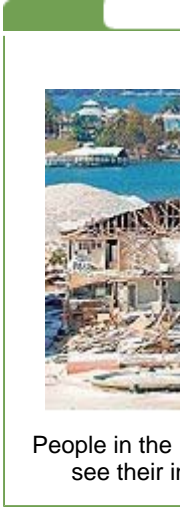
At the root of the dilemma are two simple questions: Who should pay for homeowners to live in dangerous places? insuring those people's property?

States have generally created the insurers of last resort, and though they may operate under different rules or take a different basic purpose: Covering people who could not otherwise get insurance from a private carrier. In many cases, when private insurers of last resort to run deficits, the state's other insurers are assessed fees to compensate. Those fees are levied on all policyholders, directly or indirectly, leaving property owners in safer areas to, in effect, subsidize those in riskier ones.

Some people would not be able to afford insurance at all, says Mr. Oliver, if their premiums actually corresponded to the risk. In states where private insurers have stopped writing new coastal homeowners policies in states such as New York and Massachusetts, Citizens was created by the state almost four years ago, from the former Citizens' Mutual, which operates as a nonprofit, with a board appointed by various state officials. Today it is the second largest insurer in Florida for homeowners.

Citizens already charges more than private insurers. But it also has some of the state's potentially most vulnerable policyholders are in Palm Beach, Broward, Dade and Monroe counties. Citizens also covers about 6,000 homes in Broward County. Those homes comprise less than 2% of the policies in the company's high-risk coastal account, but almost 10% of the policies in Palm Beach County alone represents nearly \$4 billion of that possible loss from the homes worth at least \$1 million.

Citizens losses can be offset by charges imposed on private-sector insurers, who generally pass those costs on to policyholders.



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through premium increases. An assessment to cover the 2004 deficit ultimately pushed premiums up nearly 7% across Florida last year. An assessment to cover the 2005 deficit could push rates up another 11% this year, though some officials propose tapping into the state's sales tax surplus -- fueled by post-hurricane spending -- to pay down some of Citizens' deficit. But Florida's Office of Insurance Regulation is now considering a request by Citizens to increase its rates, which would essentially shift more of the burden to Citizens' policyholders themselves in an effort to prevent similar deficits in the future.

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Insurance-industry officials contend that if regulators let such insurers of last resort charge rates that the risks they're covering demand, and then loosened restrictions on the rates other insurers can charge, the marketplace would solve the problem.

"When you prevent a carrier from charging an actuarially sound rate, it distorts the cost to the policyholder, the homeowner, of living in a catastrophe-prone area," says Eric Goldberg, the assistant general counsel of the American Insurance Association, a trade group. Yet dramatically increasing rates is also traumatic for homeowners, as Florida is learning.

When Frank Borcherding, a mechanical engineer, moved from Maryland to a 1,900-square-foot home in Hudson, Fla., on the Gulf Coast, in 2003, the only company offering insurance in his area was Citizens. In November 2004, he paid \$464 to cover his house for wind damage. Last November, the annual premium jumped to \$1,057. "There should be a cap on how much they can increase it every year," Mr. Borcherding says.

Florida's insurance commissioner, Kevin McCarty, indicated in a recent interview that he did not believe holding insurance rates artificially low is the solution. He was careful to note that he would not prejudice the pending Citizens rate-increase request, but he said, "if you suppress rates, you will suppress [the] supply" of insurance capital. It was a dearth of supply in willing insurers that sent John Beach to a forerunner of Citizens in the first place, after Hurricane Andrew. The private company that had insured the two-story house announced that it was dropping him as a customer.

Under the policy-renewal terms Mr. Beach recently received, the insured value of the pale pink house, built by his grandmother in 1939, would rise to \$625,000. Mr. Beach, a retired federal-government worker who lives in Maryland, and his sister, Nancy Bhargava, rent it out most of the time. Because the house does not have a mortgage, he says, no lender is demanding he purchase insurance. "We sort of do it to protect our investment," he says. Clay roof tiles are stacked up beneath a hedge under a palm tree near the entrance to the house.

The shingles were torn off by Hurricane Wilma, which hit Palm Beach in October. But Mr. Beach has not filed a damage claim. For one thing, the repair work hasn't been completed, so he has no bill. Besides, he figures the repairs won't cost more than his deductible.

Email your comments to rjeditor@dowjones.com.

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