



Flawed homeowner's flood insurance policies subsidize recklessness

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I'm not sure you can find two examples that do more to subsidize recklessness than the federal government's flood insurance program and state rate caps on homeowner's insurance. Together, these [flawed policies](http://www.heritage.org/research/reports/2009/07/homeowners-defense-act-rewards-states-for-bad-property-insurance-decisions) (<http://www.heritage.org/research/reports/2009/07/homeowners-defense-act-rewards-states-for-bad-property-insurance-decisions>) have encouraged people to rebuild homes in flood zones and drive density levels through the roof in coastal hamlets on the Atlantic Seaboard and Gulf Coast.

Millions of inland Americans pay higher homeowner's insurance rates in order to subsidize the vacation homes of wealthier people who pay rates far below what a true free market would require. As a result, homes get rebuilt in known flood zones covered by the bankrupt National Flood Insurance Program (NFIP) and the financial costs of a hurricane or tropical storm skyrocket as more and more homes get built on beaches with state rate caps keeping insurance artificially low.



(http://www.aei.org/wp-content/uploads/2016/05/RTSAFOL_flood_waters-e1463500706183.jpg)

A high water sign is submerged near Lake Bistineau in Webster Parish, Louisiana March 14, 2016. REUTERS/Therese Apel.

Refreshingly, a lonely voice has called for an end to one part of this counterproductive policy madness.

Specifically, famed [Lloyd's of London recently](http://www.ft.com/intl/cms/s/0/b3eb751c-16da-11e6-9d98-00386a18e39d.html#axzz48v6T54UU) (<http://www.ft.com/intl/cms/s/0/b3eb751c-16da-11e6-9d98-00386a18e39d.html#axzz48v6T54UU>) "called on the US government to stop providing cover for flood damage." More pointedly, Lloyd's demanded Washington get "out of the risk-taking business' and leave it to the private sector." The head of Lloyd's America noted: "If you're able to buy flood insurance on your ocean-facing property for far less from the government than you would from an insurance company, why wouldn't you just dump the risk on the government?" Indeed, under the NFIP, Americans have been doing just that for decades, with low-risk inlanders paying higher taxes and homeowner's insurance to cover the costs.

As a result of NFIP, "Although insurers in the US can provide flood cover, they are reluctant to do so as they struggle to compete with NFIP on price and mortgage lenders prefer the public sector scheme." "Struggling to compete" is a policy red flag, as it indicates government subsidization is distorting the market in a negative manner. If the NFIP ended, "the private sector would charge 'appropriate' prices that would 'prompt individuals to start rethinking how they will protect their homes and where they buy'." Translation: if

If the insurance cost of a vacation home on the beach

the insurance cost of a vacation home on the beach reflected actual risk, people likely would think twice about buying such properties.

Unfortunately and not surprisingly, reformers inside the Federal Emergency Management Agency who oversee the NFIP are being handcuffed as “Congress has slowed down the pace of the price increases” through the 2014 Homeowner Flood Insurance Affordability Act.

States are also foes of letting the market determine rates, as state insurance entities impose rate caps on insurance companies in order to spur development in areas that likely wouldn't be developed without rate caps. Don't be surprised when the next Category 5 hurricane hits the Atlantic Seaboard or Gulf Coast that Americans will have to bail out the NFIP and possibly insurance companies that couldn't build up adequate reserves to cover the damages.

With hurricane season starting in two weeks, a bailout may be just around the corner.

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Learn more: [Will Obama's luck with natural disasters continue?](http://www.aei.org/publication/will-obamas-luck-with-natural-disasters-continue/)

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| [Our dangerous reality](http://www.aei.org/publication/our-dangerous-reality/)

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