Community Finance Brief

The intersection of low-income communities and natural disasters

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Homeownership is a cornerstone of financial stability and wealth building in the United States. It has ramifications on the broader economic strength, human engagement and the overall health of community residents. Without affordable insurance, ownership (or a path to ownership) is nearly impossible and makes social mobility much more challenging for our most vulnerable communities.

The increase in and severity of natural disasters this year has increased the scrutiny on a variety of aspects related to how communities respond and prepare for such events. In light of increased climate volatility, the dramatic changes in the property insurance industry (see last week's CFB for details) has led to less options for affordable insurance, a net increase in the cost of such insurance and as a result, more challenges for historically marginalized communities.

The intersection of the lack of insurance options and low-income homeowners/renters' proximity to areas prone to natural disasters lays out a humanitarian problem: low-income and minority communities are more vulnerable to the risks of natural disasters and they also struggle the most to recover. Recent changes in the property insurance industry exacerbate this problem.The process of recovery and rebuilding is made more challenging as the way in which risk is transferred across parties leaves low-income communities with less options, making it more difficult to return to normal after a disasters and even less likely to have an opportunity to grow their position economically over the longer-term.

Quick Takes

The poorest 20% of households in the U.S. **are twice as likely** to be displaced by natural disasters as the wealthiest 20% (National Bureau of Economic Research)

Low income families take 2- to 3-times as long to **financially recover from a natural disaster** compared to national median income level families (Journal of American Family Planning Association)

By 2053, modeling shows that the annual number of buildings destroyed by wildfire will be equivalent to the **size of Asheville, NC** or about 34,000 (First Street Foundation)

"While climate change poses health threats for everyone, people of color, low-income people and other marginalized or high-need groups face disproportionate risks due to underlying inequities and structural racism and discrimination," states 2022 Kaiser Family Foundation report*. "The same factors that* contribute *to health inequities influence climate vulnerability— the degree to which people or communities are at risk of experiencing the negative impacts of climate change."*

HIGH-HAZARD AREAS & MARGINALIZED COMMUNITIES

The way in which natural disasters impact those of lesser means in this country is of particular concern given their concentration in high-hazard areas. As the the various studies point to in the **table, below**, broadly speaking, the footprint of high hazard areas is larger for historically marginalized communities. The one major

STATS & LINKED STUDIES ON CLIMATE AND SOCIAL VULNERABILITY

Low-income households:
- Are twice as likely as high-income households to be displaced by natural disasters (Brookings Institution)
- Are 1.5 times as likely than high-income households to be in areas that are at risk of flooding (National Low Income Housing Coalition)
- Make up 70% of the land within 1 mile of the country's most hazardous waste sites (Shriver Center of Poverty Law)

African Americans
- Are 1.5 times more likely than white Americans to live in areas that are at risk of flooding (Union of Concerned Scientists)
- Are more likely than all other demographic groups to live in areas with the highest projected increases in extreme temperature-related deaths (Kaiser Family Foundation)

Latino people:
- Are 48% more likely than non-Latino people to live in "high-impact" areas as it pertains to coastal flooding (Environmental Protection Agency)
- Are 21% more likely to live in the hottest parts of a city, yet 30% of them do not have access to air-conditioning (National Resources Defense Council)

exception to this trend is the that of high-income earners proximity to certain coast lines. That being said, even within those census tracks, if you move just a few blocks from the closest real estate to a coast, the median income drops significantly in many of these geographies, specifically in urban areas (Miami is the most evident here).

With that data skew noted, the natural question as to why this is the case leads to darker financial and economic history in this country and points to practices in the previous century that led to the current dynamics.

REDLINING PRACTICES IN PAST REINFORCE PRESENT DYNAMIC

The legacy of the Home Owners' Loan Corporation (HOLC) is far-reaching in the United States. The process of the federal agency's creating zoning maps of desirable and less desirable places to live from the 1930s through the 1960s created a system that resulted in people of color and those of lesser means to be concentrated together. It created a caste system of sorts within which an economic and financial tiered system developed that still exists today. It also ended up being the case that many of these areas are high-hazards when it comes to natural disasters.

> *The increasing intensity, duration, and frequency of heat waves due to human-caused climate change puts historically underserved populations in a heightened state of precarity, as studies observe that vulnerable communities—especially those within urban areas in the United States—are disproportionately exposed to extreme heat,"* notes an academic a study published in **Climate** journal. *"This study reveals that historical housing policies may, in fact, be directly responsible for disproportionate exposure to current heat events."*

Correlations with high-hazard areas, particularly when it comes to flooding and

air quality/heat, are striking the reviewing redlined areas in the nation. A 2021 Redfin study found that historically redlined community face a greater risk of flooding compared to non-redlined communities. The study reviewed 38 metro areas in the U.S. and found more than $107 billion wroth of homes at a high risk of flooding were in redlined communities. That is 25% higher than in non-redline communities. Further, people of color are more likely to live in historically redlined communities: 58% of households in formerly redlined communities are nonwhite compared to 40% that were labeled as “desireable” by the HOLC.

Heat is another area where the correlations are of note (**see quote and study,** above). Nationwide, the warmest urban areas tend to be in neighborhoods with low-income communities and those of color. In most instances, researchers can trace a link to HOLC practices. A study of 108 U.S. urban areas found that 94% of these areas displayed “consistent city-scale patterns of elevated land surface temperatures in formerly redlined areas relative to their non-redlined neighbors by as much as 7 degrees Celsius.”

“*In a mortgage system with fixed costs and dynamic profits, lenders are deterred from lending in communities of color that have lower incomes, smaller houses, and are located in areas with less demand*,” writes Emily Lynch of the University of Wisconsin-Milwaukee. “*If mortgages are not being made, the value of homes and businesses are negatively impacted, depressing the wealth of the entire community. Racial disparities in lending, equity, and wealth are further exacerbated by the rise of high-cost loans and new lending practices that target neighborhoods of color.”*

While redlining was more or less outlawed in 1968, the impacts continue to be significant. A review of real estate since the Fair Housing Act indicates that redlined areas have faired much worse. One study points to a 52% loss in property values between redlined and green lined areas from 1970 through 2010. Black homeowner are 5-times as likely to own property in a formerly redlined neighborhood than a green-lined community. This is the result of years of disinvestment.

THE DISINVESTMENT PARADIGM

The legacy of HOLC is not limited to the distribution of where people lived then to where they still live today. These same communities have suffered from decades from disinvestment that has left infrastructure not able to withstands natural disasters or provide support from these hazards at the same pace as other communities. Embedded in the economy was a mortgage business that as a result of federal policies, created massive disparities based on owning property in these communities (**see quote and study**, above).

From a macro-perspective: the average investment level in redlined areas was 15% lower than an investment in a non-redlined area in 2015, according to the Journal of Urban Economics in a 2019 report. That is a disparity that exists 40-plus years after Fair Housing Act is striking.

With this in mind, a community’s pre-existing vulnerability is not the only factor that makes these communities more exposed to climate volatility risk. It is decades of disinvestment as well as the federal government’s support that has limited many of these communities ability to mitigate risk and bounce back from events.

Overall, low-income communities and communities of color often have received less funding towards capital improvements compared to more affluent white neighborhoods. There are many

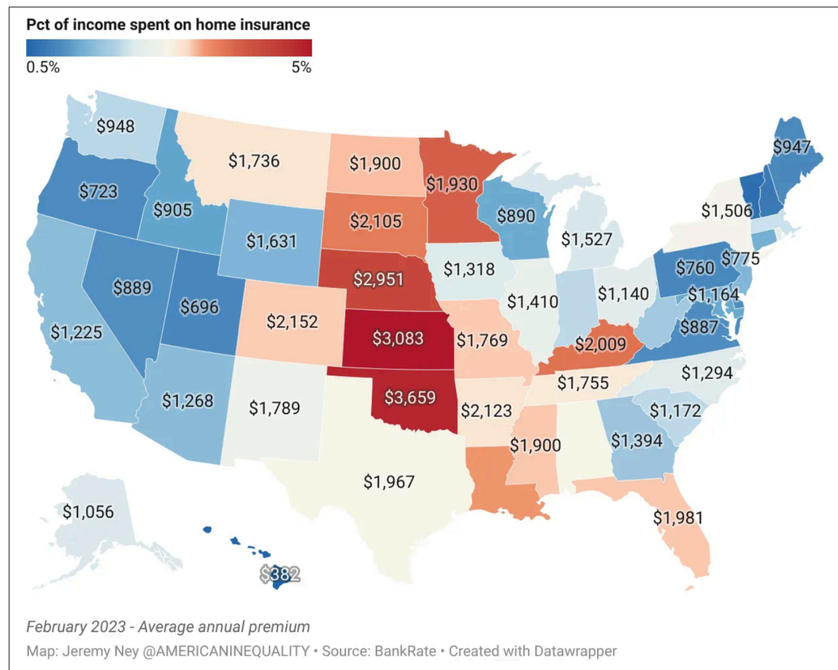
> *"By perpetually assisting larger communities that already have considerable resources, the smaller, less resource-rich, less-affluent communities cannot access funding to appropriately prepare for a disaster, leading to inadequate response and recovery, and little opportunity for mitigation,"* **a 2020 National Advisory Council report to the FEMA Administrator states**. *"Through the entire disaster cycle, communities that have been underserved stay underserved, and thereby suffer needlessly and unjustly."*

studies that review this from a transportation perspective, a hurricane perspective, a healthcare perspective, and a housing perspective. The Building Resilient Infrastructure and Communities (BRIC) federal grant program came under scrutiny recently for the way in which funds were distributed. It was FEMA that self-identified problems wherein dollars were being disseminated in ways that were not necessary helping those most in need (**see quote and report**, right). Just last week, FEMA announced $1.8 billion in BRIC funding with new criteria to address these issues.

PROPERTY INSURANCE COSTS CHALLENGE EVERYTHING

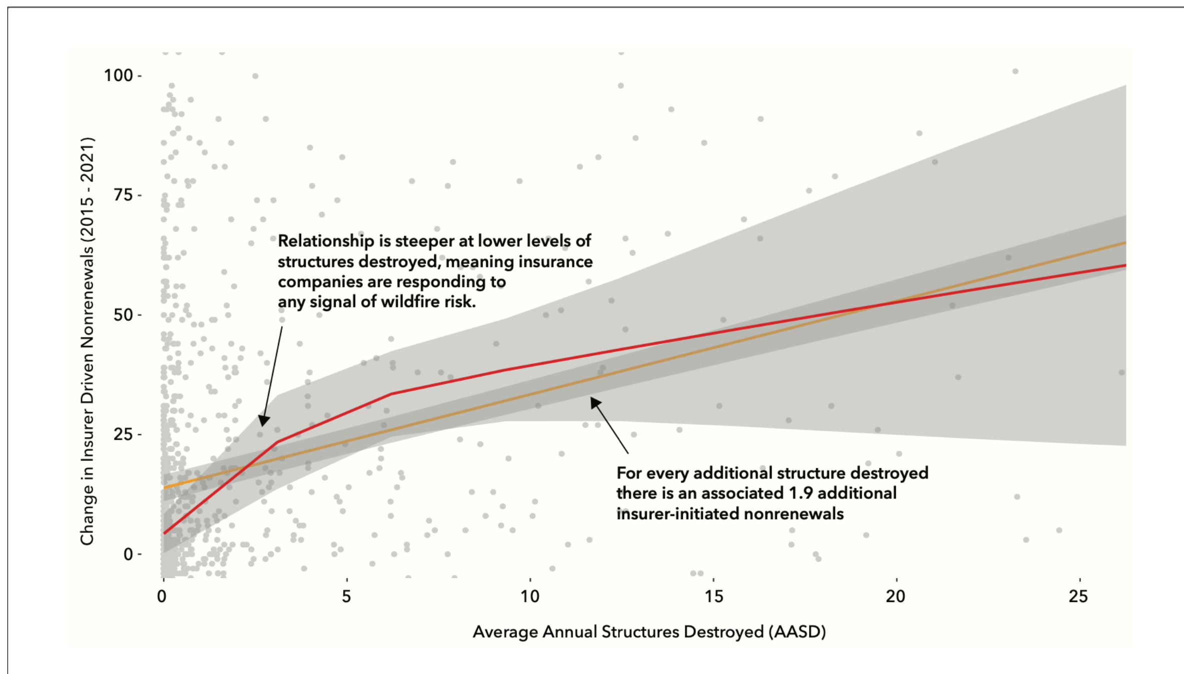
We've tried to lay an evidence-based narrative that demonstrates not only the concentration of low-income earning components of society and those that are minorities into areas that are exposed to increased climate-related hazards but that for decades these communities are less prepared than others. The linchpin behind much of this is the insurance industry.

As for redlining, the correlation of costs of insurance and zoning are high. The already-stated higher risk of natural disasters coupled with higher crime and lack of investments lead to an increase in premiums. A 2017 study by the National Bureau of Economic Research found that homeowners in redlined communities pay an average of $1,000 more per year than homeowners in non-redlined communities. **Below**, the map of the U.S. illustrates this as median income as a percentage of home insurance. Most notable in this map is the southeast, where median incomes are more on par with national averages, where as New York and California are skewed by being well above national averages. **CSG** expects the lack of affordable insurance in these states to increase premiums and percentages to adjust to reflect this in the near-term. .



With lower-income people more likely to live in neighborhoods susceptible to natural disasters, be less insulated against economic shocks of a of disaster and have less

economic means to move away from these areas - these communities are already at very high risk without taking into account the cost of insurance. Increased premiums nationwide will likely be felt more acutely on the poor. Adding to this is that these are the communities that are likely to see the largest increases because of their proximity to high-hazard areas, are less resilient and, all else being equal, higher crime rates lead to higher insurance costs.



The future direction of private personal insurance companies is clear. The Annual Insurance Assessment by First Street Foundation (found here) is the most recent comprehensive review of the state of property insurance that **CSG** has reviewed. Among various arguments, it paints a picture of premiums increasingly significantly in the United States and given the nature of where low-income communities are gathered, that cost will be born onto those less likely to persevere In the **illustration above**, First Street backs into the wildfire insurance industry looking at private insurance expected prognostications for non-renewals.

With the history and present clear, an understanding of the current infrastructure and wealth gap that insurance reinforces and the issues with government's role in the recovery, makes helping these communities of the utmost importance.

COMMUNITY FINANCE IMPACT

When it comes to public finance and how best to support these communities - the economics and politics of the current situation are problematic. These are poorer communities wherein an additional tax burden within the current community dynamic is unfavorable and thus far federal funds have struggled to meet their needs. Meantime, the current way in which risk is transferred through private insurance markets, reinsurance markets and state-sponsored insurers is proving to be long-term untenable, yet that continues to be the focus.

In Florida, for example, the state has been able to issue catastrophe bonds this year (and in the past) to essentially finance the claims on insurance companies that went bankrupt or otherwise

couldn't make claim payments. And the market appetite for such bonds is strong, especially given the strong position of the states economy and the catastrophe bonds linkage to the state's general obligation pledge. Add tort reform to reduce insurance litigation and now the Florida insurance market is on the mend, according to industry professionals, even though premiums are not expected to drop. While the bucket has, in theory, been kicked well down the road for Florida with cat bond issuance, these solutions do not address climate volatility as a long-term problem.

Generally speaking, the market for insurance-linked securities remains viable but does not represent a solution to the rising premiums. In California, the wildfire problem is large and nuanced enough that the market for securitization solutions is not as strong. Some public utilities have turned to parametric insurance, which we will discuss in future briefs.

Thinking long-term, there is a clear need for more pre-disaster risk mitigation. At the federal government level, there is a mandate for this and one for equitable approaches from the Biden Administration. Of the many efforts, we point to FEMA's Community Disaster Resiliency Zones (CDRZs) where the agency has identified areas for additional, targeting funding that looks to have taken into account a broader array of climate and socio-economic data when being selected. Through this program, the federal government will take on up to 90% of project costs in disadvantaged communities.

Looking elsewhere (and not the federal government), requires the unlocking of new revenues for state and local government. The ability to tax appears to have a hit a ceiling if one were to look at the stability in municipal bond annual issuance in the last few years as an indicator. Some thoughtful governments have begun to look the use of tax incremental financing, as a means to supporting marginalized communities with pre-disaster mitigation funding. The philosophy behind tax incremental financing in municipal bonds is to use the increased tax revenue generated by a new development to finance the cost of a separate project.

The ability to utilize physical assets that are already owned by local governments but not fully functional is an idea that would unlock new revenues for local governments. To leverage such revenues to risk mitigation efforts that are potentially not directly associated with the unused physical asset has yet to be accomplished but is something that policy makers may consider as a way to address high-hazard communities.

The structural impediments discussed in the Brief can, in one way shape or another, be tied back to a functioning property insurance market. The reliance on the current private insurance model has an outsized impact on those of lesser economic means and the process of supporting this industry without taking into account preventative measure is not cost effective if climate trends are to continue. The trends in 2023 of property insurers backing out of areas prone to climate change is **the** barometer to monitor.

The industry has begun to engage in various efforts to support pre-disaster efforts, but up until this point, policy makers have largely looked to short-term fixes for insurance. Comprehensive reform to the way in which natural disasters are prepared for, bounced back from, and broadly acknowledged through an evidence-based lens is the only way for all communities to thrive in a world where climate change exists. New revenues, unused physical assets, bond banks to facilitate lower cost of capital merged with federal funding opportunities are just the tip of the spear when thinking outside the box to address these issues.