Community Finance Brief

Government Shutdown: FEMA & Private Insurers

MATT POSNER
COURT STREET GROUP LLC

The pending government shutdown and the decline in new business by major property and casualty insurance companies in the middle of hurricane season is raising alarm bells for many communities across the country. One of the many impacts of a government shutdown next month would be that annual appropriations and supplemental funding for the Federal Emergency Management Agency that is needed to keep the disaster relief fund afloat, would not come to fruition. This leaves FEMA grossly underfunded to address emergencies this year.

Quick Takes

FEMA imposed emergency spending restrictions in early September

In late August, FEMA stopped reimbursing communities for rebuilding projects and said it would only provide money for "**critical response**"

So far this year, at least **seven** large U.S. property insurers have declined to offer new homeowner insurance or increased premiums

In California and Florida, major insurers representing around **10%** of all property insurance market share in each state have backed out, citing modeling that can't price risk effectively due to increased climate volatility

FEMA

The Biden Administration has asked Congress for $16 billion in emergency cash for the fund and an additional $20 billion for the fiscal year beginning Oct. 1st. Neither are likely to occur this week and most pundits are predicting a government shutdown come midnight on the 1st. This leaves FEMA with few options to address natural disasters for the balance of the year (and beyond, depending on how long the shutdown goes on for). Currently, the agency is tapping its Immediate Needs Funding scenario - the first time it has done that since 2017 - which entails prioritizing life sustaining disaster response and delaying payments to municipalities for reconstruction.

FEMA's disaster fund currently has a balance of $3.4 billion as of last week. To put this into perspective:

- The Maui wildfires have cost $6 billion alone so far, according to Hawaii governor Josh Green.
- This year there have been 15 individual events that have exceeded $1 billion in damages, according to the National Oceanic and Atmospheric Administration - a new record for the first 7 months of any given year on record.
- In 2023, there have been 65 federal disasters or emergencies declared since April 1st. Extreme heat and wildfires have fueled this figure. The 65 disasters and emergencies in the last 5 months is more

"A lapse in appropriations for FEMA's Disaster Relief Fund has an impact on everybody across this nation, from our ability to do life-saving actions in a number of places as well as ongoing recovery projects regardless of where they're at," - FEMA Administrator Deanne Criswell in testimony before the U.S. House of Representatives Transportation and Infrastructure Committee.

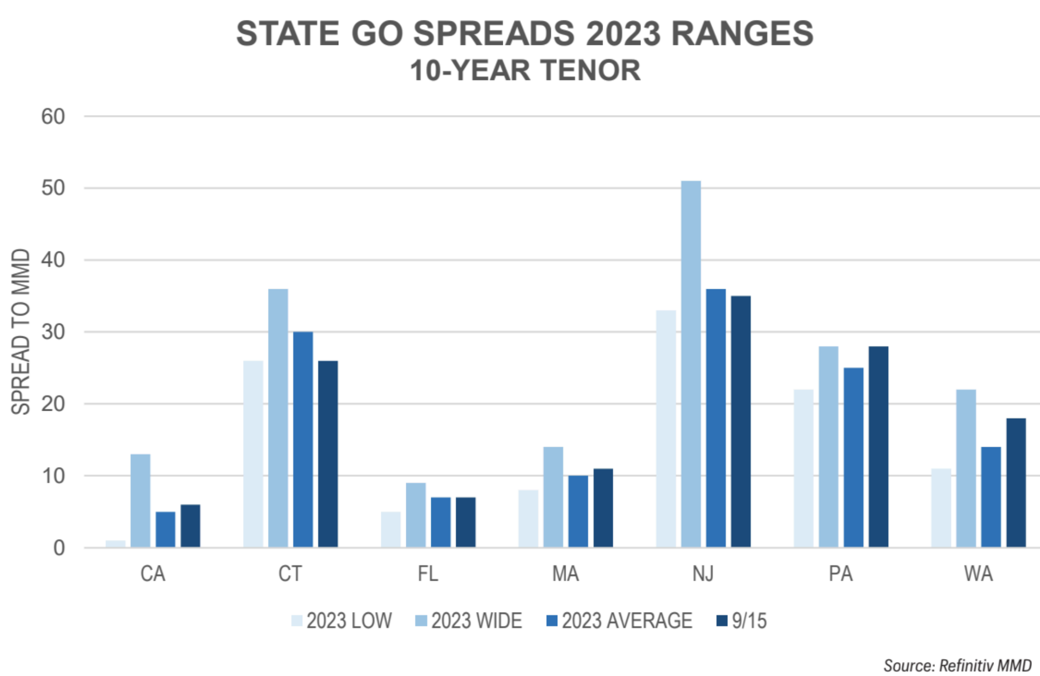
that has occurred in any full year between 1953 and 1995, according to E&E News.

P&C INSURANCE

Adding to the problem is that many of the largest property and casualty insurance companies are pulling out of areas prone to natural disasters and many of these private insurers are citing climate change and the increase in hurricanes and wildfires in certain parts of the country as the reason to decline to do new business in these areas. From 2017 to 2021, the number of property insurance companies actively writing new homeowner policies dropped by 17%, according to Statista. This decline is most pronounced in states prone to natural disasters. This has accelerated this year with at least seven insurers going public with their decision not to write new policies with California and Florida seeing the largest pull-out as Allstate and Statefarm, which represent nearly one-tenth of the industry in each state, pointed to climate change as their reason to shut down business in these states.

Insurance is a vital financial protection that is integral to virtually all commercial interactions in the United States. Property and casualty insurance, for all intents and purposes, is necessary for any construction, reconstruction or maintenance of a community in this country - whether it be personal property, government property or that of a private business. Less insurance or a higher cost of insurance directly equates to a variety of economic challenges for the communities where these changes are occurring.

Further, FEMA relies on the insurance sector to soften the blow when it steps into communities hit by natural disasters but the changes in the insurance industry portends larger negative trends for the economy as a whole, which is acutely felt for the most vulnerable communities.



PUBLIC FINANCE ANGLE

If the current course continues, during this hurricane season and wildfire season (which is nearly year-round at this point), the cost of dealing with natural disasters will fall more to the state and local governments where these communities are situated. The longer-term costs to the Federal government, which is where the buck will finally stop, will be much higher than if the disaster relief fund were to be fully funded through the end of the year.

This, however, does not solve for the bigger picture. The current status of the property and casualty insurance business in the United States is untenable. Actuarial modeling by these companies is demonstrating that they cannot price risk appropriately and expect them to continue to decline to write new policies in greater volume and in more areas - or - to increase the cost of these policies if state regulators were to allow them to.

For the municipal market:

- Headline risk in a post-natural disaster scenarios is likely for the balance of the year, which could create fund flow volatility and, as a result, rate fluctuations for certain geographies. **CSG** sees the insurance topic as grossly underreported as far as its implications for a variety of facets of community life and will continue to be writing on this topic in hopes it gains more traction with trade and national media outlets.
- It used to be the case that an acute natural disaster was a short-term credit positive as insurance money would flow into a community after a tornado hits. Instead, expect the response to be relatively muted and while we do not see this has a credit negative in the short-term, we do understand that several of the rating agencies are looking at various credits and their reliance on the availability of insurance as part of the rating matrix.
- As such, it does not seem too far a stretch to see insurance-related downgrades in 2024 in the wake of hurricane/flood/wildfire/heat season in the third and fourth quarters.
- This could have particular impact on markets in Florida and California, which are currently trading at or near historically tight spreads (see **chart,** above). This is the result of market technicals (mostly the lack of supply in each state) and has nothing to do with environmental, social or governmental events in each state, which would lead some to discount certain credits. Such is the municipal bond market…
- For areas that were receiving reconstruction funds from FEMA, if the Immediate Needs Funding protocol were to stay in place for much longer, it makes these communities more prone to future disasters but may also have a short-term negative economic impact - namely in parts of northern California (wildfires) and New England (flooding).

The shutdown debate will continue this week and will not likely revolve around FEMA funding. President Biden's strategy to lay blame on Congress for future FEMA failures is not prudent. **CSG** would point to Hurricane Katrina and President Bush's infamous quote "Brownie, you're doing a heck of a job." From the smallest locality to the White House, it is a government's response to a natural disaster where a politician does, or does not, get re-elected.

On a side note, kudos to FEMA for its recent Community Disaster Resilience Zone designations - it is a step in the direction of considering preventative infrastructure construction for communities that need it most versus the bail out approach. It is only a drop in the bucket though as a more serious debate about the future of infrastructure and how it impacts all American communities needs to take place at the national level.