Who Bears Rising Commercial Property Insurance Costs? *Discussion*

Ben Collier, UW-Madison

WISCONSIN SCHOOL OF BUSINESS

Framing

- Housing affordability a key issue → Costs of climate risk are material

- Existing work mostly on owned single-family homes
- 35% of US households (~45 million) are renters
- Huge amount (~23 million HHs) live in multi-family units

- Climate risk effects not understood for multi-family, rental property
  - Properties differ in structure/vulnerability from single family
  - Separation of housing ownership and housing consumption

This Paper

- Setting: Multi-family, commercial real estate

- Data
  - Agency CMBS deals with Fannie and Freddie (40% of multi-family mortgage debt, $2.2T)
  - Includes operating info: Rents, Net Operating Income (NOI), insurance costs
  - >100K unique properties, period 2010 – 2024

- Examines evolution of commercial insurance premiums
  - Premium trends
  - Pass-through to renters
  - Market structure implications



Results

- Insurance premium trends
  - Premiums grow a lot
  - Premiums grow fastest in reinsurance-intensive areas, a la Keys & Mulder
  - Premiums grow faster in high HO ins regulatory frictions states, a la Oh, Sen, & Tenekedjieva
  - In high frictions states, commercial insurance can cross-subsidize HO ins markets
- Pass-through to renters
  - Insurance costs are partially passed through to renters
  - Pass-through varies based on economics (e.g., market power, mobility frictions)
  - Pass-through declines in the time series; instead, higher costs reduce NOI
- Market structure implications
  - Insurance costs higher for smaller RE firms
  - Insurance costs higher for on properties in higher risk RE portfolios
  - High risk properties shift from smaller to larger firms



Comments

- Really cool paper and topic
- Novel: Little exists on multi-family commercial insurance
- Important: Housing affordability, large share of HHs
- Carefully executed
- Intuitive, useful results
- PhD student team(!)

- Suggestion(s): Shift focus from breadth to depth

There Are So Many Results

- Currently, at least 10 main results
  - “Miller’s Law” – Short-term memory can hold around 7 items
  - Ted Talks, commencement addresses, sermons, etc.: 3-ish points

- Instead, organize the paper around one economic concept
  - “Figure out the *one* central and novel contribution of your paper.” John Cochrane
  - Current paper: Many empirics soak up all the space

- Why narrow the scope? Gives room to
  - Explore the economics
  - Defend the empirics



What Are the Big Ideas?

- ~~Insurance premium trends (premiums growing, regulatory frictions, etc.)~~
  - Already well-trod via Keys & Mulder; Oh, Sen, & Tenekedjieva; etc.
  - Mostly showing external validity of existing work
  - Property insurance referees are brutal

2 Big Ideas

1. Commercial insurance pass-through to renters
2. RE market structure implications of climate risk (frictional insurance markets)



Big Idea 1
Premium Pass-Through to Renters

- Why important: Housing affordability, lots of HHs rent
- Why interesting economics → What should pass-through be?
  - How to allocate premiums between
    - Property owner (stream of cash flows) vs. Consumer (carrying costs)
  - Are premium changes permanent or cyclical?
    - Rental prices are sticky
    - Possibly: Permanent cost shifts passed to renter, temporary volatility managed by owner?
  - How does pass-through vary with market power, housing supply, mobility frictions, etc.? Already started (GREAT!)
    - Maps?
    - Structural model?



Big Idea 1
Premium Pass-Through to Renters (cont.)

- Setting details: More needed
  - Basics: Renters can buy renters insurance
  - Vulnerability differences: Highrise vs single family home
    - What are the property risks to multi-family units?
  - Liability coverage more important? (Building employees, retail on first floor?)
- Expand support current empirics
  - Pass-through: Estimating elasticities exclusively (log-log estimates)
    - Hard to interpret: Rent much larger than premiums
    - Also interested in $1 pass-through estimate for interpretation
  - NOI: 26% decline over the past decade due to insurance alone
    - Is magnitude reasonable?

Big Idea 2: RE Market Structure with Frictional Insurance Markets

- Paper already shows
  - Shift of high-risk properties from small to large property owners
  - Premiums vary with owner's RE portfolio: M&A empirics esp convincing

- Why interesting economics
  - Risk transferred to whoever can hold it at lowest cost. Depends on
    - Ability to diversify
    - Capital costs
  - Typically, we would think of insurers as having advantages here
    - If so, small firms can access diversification via insurance
    - But (re)insurance is expensive and volatile
    - → Large RE firms may hold risk at lower cost



Big Idea 2: RE Market Structure with Frictional Insurance Markets (cont.)

- Potential conclusions
  - RE firms creating diversification bc of frictional insurance markets
  - Insurance market frictions add to market power for large RE owners
  - Aside: Do we need a US federal reinsurer?

- Setting details needed
  - How is insurance structured by larger RE firms to reduce costs?

  - Insurance captives?
    - Insurer owned by RE group
    - Transfer tail risks via reinsurance
    - Meets CMBS requirement
    - Captives can be regulated differently than arms-length insurers



Conclusion

- 23 million US HHs live in multi-family units
- Housing affordability a key issue → Costs of climate risk is material

- Cool paper and topic
- Novel: Little exists on multi-family commercial insurance

- Suggestion(s): Shift focus from breadth to depth