(UBS)

Are homeowners recognizing climate risk?

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Physical and transition risks from climate change are becoming more acute for real estate, especially as the impact of extreme weather events intensifies and triggers responses from regulators and insurers. However, it is not clear whether this impact has been sufficiently embedded in the residential real estate market. We look at the US as a case study of the complex set of decisions driving homeowner behavior.

This year has seen a record number of flash flood emergencies, the highest level of risk warning, issued by the National Weather Service. About half of the emergencies were triggered by four hurricanes, including the devastating Hurricane Helene and Hurricane Milton, which are each projected to have a USD 50bn cost. Moody's estimates private market insured losses of USD 36bn from the two storms. Climate change translates into two types of risk: physical risk from more extreme acute events like weather-related natural disasters or from gradual changes like sea level rise, and transition risk which includes societal changes in response to climate change.

Real estate can be impacted by both physical risk—as we have seen in recent disasters—but also by transition risk, in particular as insurance providers increase rates or exit specific markets, impacting home value. There is some early evidence of this becoming a trend: Major insurers like AllState, StateFarm, and Farmers Insurance have scaled back their operations in California and Florida, citing the rising costs from rising hurricane or wildfire risks. Consistent with the record number of flash floods in the country, according to LexisNexis, nearly half of all claims in 2023 were catastrophe related, and hail-related claims have increased by nearly 58% since 2022. The costs are being passed on to homeowners with the average cost of home insurance increasing 21% nationwide between 2015 and 2023, according to LexisNexis.

But has this changed the behavior of homeowners and impacted home prices? The answer is not straightforward as climate risks manifest differently across states and issues like rising insurance costs are weighed against other elements.

However, it looks like the states that have seen the highest growth rate of new homes built are also seeing the higher financial impact from weather events.

The tide may turn, however, as climate risk data are becoming more available to underwriters and homeowners. Fannie Mae and Freddie Mac, two government-sponsored enterprises that play a crucial role in the housing financing system in the US, are now both integrating climate data in their analysis. Also, consumer-facing websites like Realtor.com and Zillow will show buyers a climate risk rating for properties, bringing the information to the forefront.

Takeaways for investors:

- Physical and transition risks are becoming more apparent globally and across real estate sub-asset classes, in particular as data on physical risk becomes broadly available.
- Looking at the US residential real estate market as a case study, it's unclear whether the risks are currently being reflected in home value, homeowner, and investor decisions.
- As more data become available, investor focus may shift to companies with less exposure to carbon-heavy assets or to climate risk.

For more, see **Sustainable investing perspectives: Trump 2.0, real estate risk, and global biodiversity summit** , 6 November, 2024.