



Editorial Introduction

Climate change is causing more, and more extreme, weather events. It is also causing distinct socio-economic concerns for home owners. Homes in *at-risk* areas generally have a lower value than homes located elsewhere, making those homes appear more affordable. However, the cost of home insurance is often higher than in other areas, which can result in no insurance for, or under insurance of, those homes. This can have disastrous consequences if an event happens. Separately, if the home is not properly insured, the owner may also be in breach of their mortgage obligations. This briefing paper contributes to understanding climate change's impacts for home owners.

About the Author

Dr Lucy Craddock is an Associate Professor in the QUT Law School, Faculty of Business and Law, QUT.

Home ownership and mortgage obligations: Other impacts of climate change

<https://doi.org/10.5204/book.eprints.xxxxx>

Lucy Craddock

Introduction

Buying a home can be an exciting milestone. It can be the largest financial commitment an individual makes, but one they can rely on in retirement (Baulkaran & Jain, 2024). To make their dollar stretch further, many owners choose to *not* do certain things. Sometimes these are lifestyle choices, i.e., reduce the takeaway coffees they buy. In other instances, a choice may be made to minimise perceived less essential home-related expenditures, i.e., insurance. Regrettably, such choices may mean a home is not properly protected against the adverse impacts of climate change. Concurrently, where an individual has borrowed to buy their home, any failure to properly insure may breach their mortgage obligations.

This briefing paper explores this often-unconsidered climate change-related risk.

Climate change impacts

The increasing adverse effects of climate change are seen in the increased number and severity of water-related events, which put land in riverine and coastal areas at particular risk (Goodell, 2017; Warren-Myers & Hurlimann, 2021). This includes sea level rise, riverine and overland flooding, and the resulting landslip of waterlogged areas (Jia et al., 2019). Flood risk is particularly prevalent, and “[over] *one million [Australian] private properties, or about one in 10 homes, have some level of flood risk*” (ICA, 2022).

Despite the known impacts of climate change, it is still common throughout Australia for developments in *at-risk* areas to receive approval. (Craddock & Warren-Myers, 2022) Therefore, the reality is that more people are living in areas at direct risk from one or more climate change events than previously (Craddock et al., 2020).

'Affording' home ownership

Many home owners, particularly first-time buyers, are assisted to purchase through federal or State schemes (Martin & Pawson, 2024). However, even with that support, many still need a mortgage. That mortgage most likely will include certain core obligations: make repayments when due; maintain the property; and have a certain level of building insurance, sometimes with a list of risks to be insured against. Failing to meet these, or other, obligations can give the financier a right to sell the property (see s.113(1)(a), s.114(1)(a) PLA).

Ongoing increases in mortgage interest rates (ABS, 2024) means households have less money available for other expenditure. Concurrently, increasing house prices also adversely impact financial capacity, resulting in the need to borrow more money (Caloia, 2024). Consequently, where an individual does not have the capacity to borrow more money to buy their home, the only alternative is to buy a less expensive home. This may mean buying in an *at-risk* area.

If a property has been adversely impacted by any risk – climate related or otherwise – this is something that needs to be considered and factored into its current value (IVS, 2022). The more recent and/or more adverse an event, the greater the negative impact may be on the value of that property, which can result in a lower market price and lower sale price. These events also may influence the decision to lend, the amount available to the buyer, and the mortgage terms provided (Duanmu et al., 2022).

While some individuals may choose to buy in an *at-risk* area for amenity reasons, i.e., to be close to the coast, or river, or because of the view (Cradduck, 2016), for others it is not a real choice (Legal Aid, 2023). As the true cost of ownership also includes the after-purchase costs, such as maintenance, mortgage repayments, and insurance (ABS, 2023), the need for financial capacity does not end at settlement.

Location may influence purchasing decisions; however, it also impacts insurability and affordability of insurance (Cradduck & Teale, 2014). A complicating factor of climate change is *at-risk* areas are not 'static', as seen, for example, in the updated flood modelling of Greater Melbourne (MWC, 2024). While many cannot afford to buy elsewhere, equally they cannot afford to live where they buy as they cannot afford the insurance to live in an *at-risk area* (Nicola, 2024).

Insurance

Since 19 June 2014, in the wake of the 2010-2011 Queensland, New South Wales, and Victorian floods, a standard definition of 'flood' applies to certain insurance contracts (Hawke, 2016). In '*home building*' insurance contracts '*where [an] insured ... is a natural person*' (s.18 ICR, 2017), 'flood' means "*the covering of normally dry land by water that has escaped or been released from the normal confines of any of ... a lake ... a river ... a creek ... another watercourse ... a reservoir ... a canal ... [or] a dam*". (s.34 ICR, 2017; s.37B(2)(a) ICA, 1984; s.18 ICR, 2017)

The statutory definition of flood applies irrespective of any other definition in an insurance policy (s.37D(1) and (2) ICA, 1984). However, this does not mean the *level* of cover selected will be adequate, or that an owner will want flood cover, or that they will be able to afford flood cover if they do want it (Nicola, 2024). Therefore, a statutory definition of 'flood' does not solve the lack of appropriate cover.

There are various reasons why owners do not take flood cover: income and education of the individual, and the price of insurance, are key considerations (Atreya et al., 2015). While it may appear an individual has made a *choice* to not have flood cover, often they do not have cover because they cannot afford it. Separately, an individual may not properly understand the details of their insurance policy, due, for example, to the differences in policy wordings used by insurers (Legal Aid, 2023), and therefore they do not understand whether (or to what level) flood is in fact covered. They also may not have cover because they do not truly understand the risk to their home (Cradduck & Teale, 2014).

Recent increases in home insurance premiums together with increased interest rates have increased living costs for households, with "*rises ranging from 3.3 per cent to 6.5 percent*" depending on the particular household (ABS, 2024). Concurrently, insurance premiums have increased "*16.4 per cent annually, which is the strongest annual rise since 2001*" (ABS, 2024). These increases reflect various matters, including the impact of natural disasters. These increases also make the ongoing ability to have appropriate insurance cover even more unaffordable for those least able to afford it (Legal Aid, 2023).

A lack of appropriate insurance will mean little or no cover if an adverse event occurs. A lack of insurance also may have other impacts beyond the immediate flood event.

Consequences

An adverse climate change event will reduce the value of a property (Farhaoui & Slimani, 2022). Individuals who cannot afford to buy elsewhere will buy homes in *at-risk* areas. However, due to other factors, i.e., increasing interest rates and costs, they may be unable to afford appropriate insurance. If they do not have appropriate insurance, they then may be in breach of their mortgage, which may not be realised until after an event occurs and they are unable to rectify the breach as they cannot obtain insurance. If their financier needs to sell, this may further reduce the value of their property, through both a forced sale and being made after an adverse event. At the same time, the existence of a recent adverse event will increase the cost of insurance. As Figure 1 depicts, climate change has created a vicious property cycle:

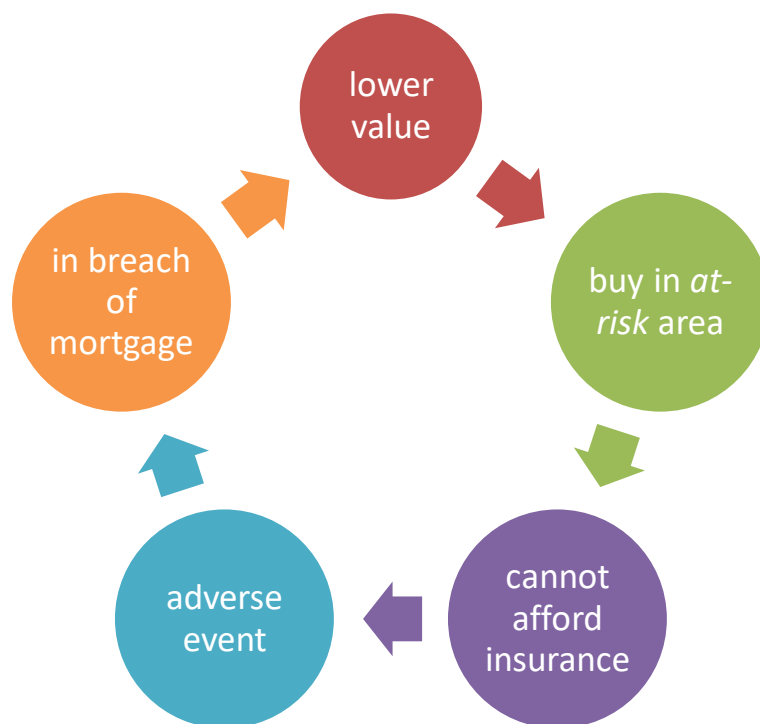


Figure 1: *Climate change risk cycle*

Land planning is primarily a function of State and local governments. Unfortunately, not only can these governments not be relied upon to make appropriate planning decisions, governments also cannot be relied upon to provide adequate support after a climate change event. Those adversely impacted by an event often find any government support they may be entitled to claim is not sufficient to place them in the same position as if they had been fully insured. Further, such support cannot cure any breach of their mortgage arising due to a lack of appropriate insurance.

The future

Climate change risks are both obvious and hidden – when an event occurs the resulting devastation is all too obvious, but often until an event happens many individuals cannot imagine such an event could occur where they live. As both property prices and interest rates continue to increase, buyers look more and more both to maximise what they can buy with their available budget and minimise post-acquisition expenditure. They also look to government decision-makers to make decisions appropriate for everyone's future.

Issues of housing affordability require specific and separate attention and action by governments at all levels. In the meantime, those on lower incomes or with other financial constraints are attracted to more affordable homes. Regrettably, to make their dollar stretch further, many home owners must reduce their expenditure. This includes not being able to properly protect themselves from the adverse impacts of climate change by ensuring they have adequate and appropriate home insurance. This, in turn, can put those owners at risk of action by their financier for breach of their mortgage.

Continuing to permit homes to be built in *at-risk* areas is merely perpetuating the *climate change risk cycle*. While any solution regarding existing developments in these areas may be complex, as regards future development the solution is clear. For all our sakes, and for the protection of Australia's future generations, it is time to prohibit any future development in at-risk areas (Craddock & Warren-Myers, 2022).

References

- Atreya, A., Ferreira, S., & Michel-Kerjan, W. (2015). What drives households to buy flood insurance? New evidence from Georgia. *Ecological Economics*, 117(C), 153-161.
- Australian Bureau of Statistics. (2023). *Housing cost measures in the National Accounts*. ABS. <https://www.abs.gov.au/articles/housing-cost-measures-national-accounts>.
- Australian Bureau of Statistics. (2024). *Living cost increase highest for Employee households*. ABS. <https://www.abs.gov.au/media-centre/media-releases/living-cost-increase-highest-employee-households>
- Baulkaran, V. & Jain, P. (2024) Home equity and retirement funding: Challenges and opportunities, *Global Finance Journal*, 61 (2004) 100969, <https://doi.org/10.1016/j.gfi.2024.100969>.
- Caloia, F. (2024). Borrower-based measures, house prices and household debt. *Journal of International Money and Finance*, 143, 103051, 1-17.
- Craddock, L. (2016). After the rains: water's impact for valuation practices. *Property Management*, 34(2), 158-174.
- Craddock, L., & Teale, J. (2014). A sunburnt country - storms, surges and sea levels: of insurance and flooding rains. *Geography Research Forum*, 34, 123-141.
- Craddock, L., & Warren-Myers, G. (2022). Development in a state of climate change: an Australian case study of government response. *Journal of Property Investment and Finance*, 40(4), 362-380.
- Craddock, L., Warren-Myers, G., & Stringer, B. (2020). Courts' views on climate change inundation risks for developments: Australian perspectives and considerations for valuers. *Journal of European Real Estate Research*, 13(3), 435-453.
- Duanmu, J., Li, Y., Lin, M., & Tahsin, S. (2022) Natural Disaster Risk and Residential Mortgage Lending Standards, *Journal of Real Estate Research*, 44(1), 106-130.
- Farhaoui, M. & Slimani, C. (2022) Effects of Climate Change on Real Estate Value, *London Journal of Research In Science: Natural and Formal*, 22(12), Compilation 1.0.
- Goodell, J. (2017). *The Water Will Come: Rising Seas, Sinking Cities, and the Remaking of the Civilized World*. Little, Brown and Company.
- Hawke, F. (2016). Insurance and flooding - issues for domestic and small business property owners. *Australian Environment Review*, 31(9), 320-323.
- Insurance Contracts Act 1984 (Cth) ('ICA')
- Insurance Contracts Regulations 2017 (Cth) ('ICR')
- Insurance Council of Australia (2022) *Climate Change Impact Series: Flooding and Future Risks*, May 2022.
- International Valuation Standard 2022 (IVS)
- Jia, G., Shevliakova, E., Artaxo, P., De Noblet-Ducoudré, N., Houghton, R., House, J., Kitajima, K., Lennard, C., Popp, A., Sirin, A., Sukumar, R., & Verchot, L. (2019). *Land-climate interactions*. In P. Shukla, J. Skea, E. Calvo Buendia, V. Masson-Delmotte, H. Pörtner, D. Roberts, P. Zhai, R. Slade, S. Connors, R. van Diemen, M. Ferrat, E. Haughey, S. Luz, S. Neogi, M. Pathak, J. Petzold, J. Portugal Pereira, P. Vyas, E. Huntley, K. Kissick, M, Belkacemi, & J. Malley (Eds.), *Climate Change and Land*. (pp. 131-247). Cambridge University Press.
- Legal Aid (2023). *Submission to Inquiry into insurers' responses to 2022 major floods claims*, House of Representatives Standing Committee on Economics, October 2023 https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/FloodInsuranceInquiry/Submissions
- Martin, C., & Pawson, H. (2024). Australian first home ownership assistance schemes: International comparison and assessment. *Australian Economic Papers*, 1-23.
- Melbourne Water Corporation ('MWC') (2024) *2024 Maribyrnong River Flood Modelling Project Summary Report*, 24 April 2024, https://hdp-au-prod-app-mw-yoursay-files.s3.ap-southeast-2.amazonaws.com/7617/1436/3429/IA5000NN_REP_005_Summary_Report_003_FINAL.pdf
- Nicola, A. (2024). SEQ flood victim shocked at 500pc home insurance hike. *Courier Mail*, 2024, January 9, 10:30am.
- Property Law Act 2023 (Qld) ('PLA')
- Warren-Myers, G., & Hurlimann, A. (2021). *Climate change and risk to real estate*. In P. Tiwari & T. Miao (Eds.), *A Research Agenda for Real Estate* (pp. 139-166). Edward Elgar.