Home Equity Insurance

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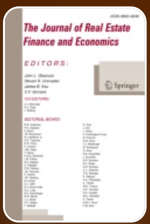

The Journal of Real Estate Finance and Economics

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Abstract

Home equity insurance policies—policies insuring homeowners against declines in the prices of their homes—would bear some resemblance both to ordinary insurance and to financial hedging vehicles. A menu of choices for the design of such policies is presented here, and conceptual issues are discussed. Choices include pass-through futures and options, in which the insurance company in effect serves as a retailer to homeowners of short positions in real estate futures markets or of put options on real estate indices. Another choice is a life-event-triggered insurance policy, in which the homeowner pays regular fixed insurance premia and is entitled to a claim if both a sufficient decline in the real estate price index and a specified life event (such as a move beyond a certain geographical distance) occur. Pricing of the premia to cover loss experience is derived, and tables of break-even policy premia are shown, based on estimated models of Los Angeles housing prices from 1971 to 1994.

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