A Conversation with Charlie Amato

Texas Economy Remains Strong Despite Challenges

Charlie Amato is chairman and co-founder of Southwest Business Corp. (SWBC), a company with 17 lines of business including insurance brokerage, financial planning, employee benefits administration and mortgage servicing. Amato, who has more than 40 years of experience in all aspects of insurance operations, offers insights into issues the Texas economy faces.

Q. While SWBC has worldwide operations, much of its business is in Texas. Given that, how do you see conditions in the state this year?

SWBC is headquartered in San Antonio, and yes, we have offices across the country. The benefit to being in Texas is that it's a pro-business environment, and our elected officials encourage economic growth.

The economy is the strongest I have ever seen. Generally speaking, the U.S. is doing well, and Texas is doing even better. Within our company, all of the divisions are making money—and that is pretty rare. I am optimistic, as uncertainty has decreased since the fourth quarter of last year and business activity is robust.

Q. Texas housing prices have appreciated sharply over the past five years. How do you see this affecting housing markets?

There is no question that home price appreciation has negatively impacted affordability. However, there are still a number of good financing options for most people.

Fannie Mae's Home Ready mortgage program and Freddie Mac's Home Possible mortgage program provide 97 percent financing and waive certain risk-based pricing adjustments for borrowers at or below the HUD median income for the area. The Federal Housing Administration [FHA] and VA [Veterans Administration] also have good programs for low- to moderate-income earners.

One of our biggest concerns is related to the potential consequences of government-sponsored enterprise reform (covering Fannie Mae and Freddie Mac). The Dodd–Frank Act established standards that a lender must meet to document that a borrower has the ability to repay a loan.

A lender has a safe harbor for liability with respect to loans that meet the requirements deemed to constitute a qualified mortgage [QM]. These QM standards include a debt-to-income ratio cap of 43 percent or, in the alternative, eligibility for Fannie Mae and Freddie Mac, FHA or other government programs.

The availability of these government-sponsored loan programs for higher-indebted borrowers is commonly referred to as the "QM patch." Regrettably, the QM patch is set to expire in 2021. Allowing the QM patch to expire would have a negative impact on housing affordability that would disproportionately affect low- to moderate-income borrowers.

There is a market among private investors for loans that do not meet the QM standards. However, the interest rates for those loans are significantly higher due to the increased risk associated with the lack of a safe harbor.

Q. SWBC is a large insurance brokerage. How did Hurricane Harvey affect mortgage delinquency and what would be the impact of continued severe weather events?

Our total mortgage delinquency percentage for the Houston area more than quadrupled from July 2017 to its peak in October 2017. Delinquencies returned to normal levels beginning in November 2018.

Quite a bit of the flooding occurred in areas outside of designated "special flood hazard areas," meaning many affected homeowners were not required to carry flood insurance and few did so. Since much of the flood coverage that was in place was purchased through the National Flood Insurance Program [NFIP], there was no immediate increase in flood insurance cost. There are reports that NFIP plans to adopt a new rating structure, Risk Rating 2.0, where new rates are expected to take place in 2020. The expected result is likely to increase NFIP insurance costs in higher-risk areas, which could create a drag on the housing market in those areas.

Q. In general, what percentage of flood insurance is from private insurance companies and how will this change in the future?

Private companies represent about 15 percent of policy premiums, although much of the private insurance is covering losses exceeding the $250,000 cap set by the NFIP. Private companies historically have had difficulty participating in the market. One major issue has been the inability to properly underwrite policies, with lending regulations that did not explicitly allow private flood insurance policies.

Many lenders were hesitant to accept private flood policies as a result. This will change due to a final rule issued by federal lending regulators that takes effect July 1. The likelihood that a private insurer would be wiped out by a major flood in a region is small since many insurers reduce regional risk by reinsurance with companies in different areas

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of the world through intermediaries such as Lloyd's of London.

A major impediment to the privatization of the flood insurance market is tied directly to the guidance and messaging delivered by the federal government and its FEMA [Federal Emergency Management Agency] representatives. Even today, it is difficult to determine if the government will consider private companies as competitors or partners within the next five to 10 years.

Recent announcements regarding FEMA's plans to revamp the NFIP by creating a new rating model [Risk Rating 2.0] has caused many private companies to rethink their flood insurance strategies. In the past, NFIP rates were the same across any given flood zone. Private insurers, however, use the latest mapping tools and improved data to create accurate and precise risk modeling within flood zones so that they can price differently based on the risk of flooding.

If FEMA uses a similar pricing method with its new rating model, then private insurers may be priced out of the market in the lower-risk areas of flood zones where they have successfully acquired customers in the past.

The fact remains, however, that despite these challenges, the flood insurance market will become a more competitive space as private companies gain market share and expand their underwriting guidelines to include riskier properties. We are confident that progress will be made and private flood insurance options will become more relevant and necessary in the future.

Q. You are involved in the multifamily housing market in Texas. How is this sector doing?

The multifamily housing market is still doing well in Texas. The increase in the number of jobs is causing more people to move here. Additionally, we're seeing a higher percentage of renters in the general population—some by choice, some by necessity.

Challenges include limited availability of suitable sites to construct new multifamily housing, cities' and communities' reluctance to allow new multifamily projects, and increases in construction costs, including labor and materials.

A significant opportunity is in the renovation market. Most older developments are located close to jobs, amenities and retail services the tenant market desires. Usually these types of projects need minimal remodeling to bring them up to new construction standards, and the cost to acquire the project is 20 to 30 percent lower than new construction.

Q. How is labor market tightness affecting SWBC? Has the company changed how it does business as a result?

The impact has been felt in recruiting and retention. On the recruiting side, the volume of available candidates has decreased. This has caused us to become much more adept at the use of social media to cast a wider net to let passive candidates know we are hiring, especially in the very competitive IT [information technology] space.

Generally, we have still been able to find quality applicants, but the process has become more elongated to attract top candidates. Most companies are doing everything possible to retain their high-performing employees. The number of counteroffers to candidates from their current employer has grown considerably over the past 12 to 18 months.

Regarding retention, in 2018 SWBC put in place a top-performer program in its largest division. This was a way to ensure at staff levels that the best-of-the-best were eligible for incentive compensation on top of an already strong base pay.

In our real estate business, our construction partners say that with the aging of true craftsmen and a shortage of younger qualified tradesmen, work production and quality have declined. This results in heavier burdens on superintendents and project managers to get the job done. We spend more time analyzing the workload and scheduling commitments of prospective contractors to ensure timely completion of our projects. In addition, we're paying closer attention to younger talent—looking for individuals capable of being groomed into leadership roles.

Q. Historically, the Texas economy has grown faster than the national average. Given your experience, why is this, and will this edge remain in the future?

Texas has one of the best economies in the nation. I believe its main strength is that it's one of the most diversified state economies. It also is a low-tax-and-regulation state.

An example is the tort reform [affecting civil lawsuits], which was passed in 2003. At the time, the very high cost of malpractice insurance was driving many doctors to leave Texas or to retire early. I was on the board of a hospital at the time, and it was a severe problem. The Legislature was able to pull together to resolve that issue. Texas is a business-friendly state with regulations that encourage business success, and I don't see that changing any time soon.