# Study: After Hurricane Katrina, personal debt fell for those worst hit—but at a cost

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Justin Gallagher, assistant professor of economics at the Weatherhead School of Management, Case Western Reserve University. Credit: CWRU

After Hurricane Katrina devastated New Orleans a dozen years ago, there was a sharp and immediate drop in personal debt among residents living in city's most flooded blocks, according to a new Case Western Reserve University study.

Yet, the main driver of this debt reduction—using flood insurance to pay off mortgages of damaged homes, rather than rebuilding or repairing them—may ultimately harm the city's recovery, the study suggests.

"While paying down mortgage debt is usually seen as a positive, if homeowners do this and move, then it could slow the rebuilding of neighborhoods—especially if residents are more likely to return when others do," said Justin Gallagher, an assistant professor of economics and co-author of the study, published this month in the *American Economic Journal: Economic Policy*.

New Orleans residents with local mortgage lenders were more likely to rebuild their homes—a buoy to neighborhoods.

But the propensity to pay off mortgages—and not rebuild—was especially high in the deepest-flooded neighborhoods.

"Residents in these areas were the ones facing the difficult decision to rebuild or pay down debt," said Gallagher. "And residents in these areas with non-local mortgage companies were much more likely to choose to decrease debt than rebuild."In many cases, lenders must approve how homeowners use flood insurance payouts and can create conditions and pressures for how the money is spent.

"The findings suggest that the higher number of mortgages provided by local lenders can result in a more positive impact on a community's redevelopment after a natural disaster," Gallagher said.

After Katrina, new mortgages by nonlocal lenders fell sharply, relative to those by local lenders.

Causing an estimated $108 billion in property damage, Hurricane Katrina hit New Orleans on Aug. 29, 2005 and flooded 85 percent of the city after its levees were breached by a surge of storm and coastal waters.

In the U.S., more than 200 weather and climate disasters have exceeded

$1 billion in damages since 1980, with a total cost exceeding $1.2 trillion, according to the National Oceanic and Atmospheric Administration.

Yet, relatively little is known about how people affected by natural disasters cope with the resulting financial shock, said Gallagher, though the U.S. government has many longstanding programs to do so.

After Katrina, researchers found that the worst-flooded residents relied on credit cards in modest amounts—incurring an average temporary increase of 15 percent, or $500, in new credit card debt. (Though, there was some evidence of a tightening overall credit market for flooded residents.)

In addition, two broad measures of financial health—debt delinquency rates and credit scores—showed short-lived and modest increases: The worst-flooded residents had 90-day delinquency rates that were about 10 percent higher, relative to non-flooded residents, for the three months following Katrina.

Daniel Hartley, a policy economist with the Federal Reserve Bank of Chicago, co-authored the paper.

**More information:** Justin Gallagher et al. Household Finance after a Natural Disaster: The Case of Hurricane Katrina, *American Economic Journal: Economic Policy* (2017). DOI: 10.1257/pol.20140273

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