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STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED FOR THE RECORD TO THE

UNITED STATES SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

HEARING REGARDING

REAUTHORIZATION OF THE NATIONAL FLOOD INSURANCE PROGRAM

JUNE 9, 2011

Introduction

On behalf of 1.1 million members engaged in all aspects of residential and commercial real estate, the National Association of REALTORS® (NAR) appreciates the opportunity to submit this written statement regarding reauthorization of the National Flood Insurance Program (NFIP). NAR urges Congress to reauthorize the NFIP for a full five-year term and end the many stopgap extensions and shutdowns that have only exacerbated uncertainty in recovering real estate markets.

The NFIP ensures access to affordable flood insurance for 5.6 million American home- and business owners across the United States. This protection is vitally important as annual flooding claims dozens of lives and billions of dollars in property loss, making it one of the most prevalent and expensive natural disasters in U.S. history. By law, flood insurance is required in order to obtain a federally related mortgage in more than 21,000 communities nationwide. By adopting NFIP regulations and building codes, these communities have averted $16 billion in property loss since 2000, according to the Department of Homeland Security. This program saves taxpayers both property and money.

The program is again set to expire on September 30, 2011. This will be the **tenth time** in less than three years that Congress has had to extend program authority. **Twice**, that authority was allowed to expire in 2010 for multiple weeks each time. The lapse last June alone, during a down real estate market, resulted in the delay or cancellation of 47,000 home sales according to NAR survey data. While we thank the House for including a straight one-year extension in its Homeland Security appropriations bill for 2012 (H.R. 2017), we believe that five years is the minimum timeframe necessary to provide some certainty for real estate markets, which continue to struggle amid the longest recession since the Great Depression. In any event, we urge the Senate not to let the NFIP lapse again, as that would only further undermine the already fragile confidence in these key markets upon which the U.S. economic recovery depends.

Before turning to specific reforms, we would like to discuss the legislative history and address several common myths about the NFIP. In short, the NFIP was created and continues to address an on-going failure of the private market to provide access to affordable flood insurance. Without this program, the only way for many owners to rebuild after a flood would be for the federal government to appropriate post-disaster rebuilding assistance – using taxpayer dollars.

Legislative History

The NFIP was created in 1968 after Hurricane Betsy because there was no private market alternative for flood insurance. Historically, most communities were built along rivers and coastlines. Because flood victims could not turn to the private market to insure and pre-pay for the flood damage, many communities were forced to look to the federal government for rebuilding assistance. Given the level of devastation and homelessness among families and communities, Congress had little-to-no choice but to respond to each major flood with yet another supplemental disaster relief package of subsidized loans, grants and public assistance – all at taxpayer expense.

In the aftermath of Hurricane Betsy, the federal government could no longer ignore the rising cost to taxpayers of such a backward-looking public policy toward floods. One of the champions of a federal flood insurance program, Rep. Hale Boggs said it best:

"…As you know, I represent an area which 2 years ago was horribly battered by Hurricane Betsy. But hurricanes and floods are not district or regional problems. They are national problems. No one knows where they will strike. And they require national solutions now before thousands more are hit without adequate protection. Mr. Chairman, we should attack this problem through an insurance program instead of relying totally on direct Federal subsidies to the victims of floods basically for two reasons: First, our people want the opportunity to protect themselves. They do not want to rely on relief agencies, Government largesse, or charity. They want to protect themselves and it is up to us to help them do it. Passage of this legislation will go a long way in helping people to protect themselves against flood disasters. Second, as I said a moment ago, we have relied on ad hoc, piecemeal relief measures for many years and it is now abundantly clear that, although these temporary programs have been helpful, they are insufficient and quite costly. We have been legislating after the fact and it is time to plan for the future rather than react to the past…."[1]

The result was establishment of a HUD Commission, authorized by Congress and convened by President Johnson, which in 1966 recommended creation of a federal flood insurance program as an alternative to the government rebuilding aid. According to the Commission, every insured property would mean one fewer property would have to be rebuilt with taxpayer dollars.

Although the NFIP has been reauthorized multiple times over the years, the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 (P.L. 108-264) was the last multi-year reauthorization bill to become law. Subsequently, the 110th Congress was on the verge of approving a subsequent reauthorization (H.R. 3121, the Flood Insurance Reform and Modernization Act), but did not convene a conference committee as attention turned to the problems facing the U.S. financial system. The Congress did return to the subject last session, when the House approved and the Senate began its review of the Flood Insurance Reform Priorities bill, H.R. 5114, with a hearing at which NAR testified about the program's importance. Ultimately though, the 111th Congress was not able to complete its work on the legislation and the NFIP's authority had to be extended for the ninth time, bringing the total number of lapses since 2008 to five; two of these lapses were for multiple weeks just last year. The program is next set to expire on September 30th of this year.

Common Myths

Neither data nor fact supports assertions of 1) the ability of a private market for flood insurance to fill the void left by privatizing the NFIP; 2) the existence of a cross subsidy from non-coastal to coastal states under the program; or 3) a cost to taxpayers from NFIP borrowing or repeated pay-outs for certain properties. It is simply the nature of a private market that it will not guarantee either the availability or the affordability of flood insurance. However, if the program is ended, the only way to rebuild after a flood would be for Congress to respond as it did prior to 1968, which is to approve more taxpayer-funded disaster relief.

Myth #1: The Private Market Will Meet the Flood Insurance Demand.

Legislation has been introduced by Rep. Miller of Michigan in the House (H.R. 435) to terminate the NFIP by 2013. NAR strongly opposes this bill or any effort to privatize the NFIP. The premise underlying such an effort is that there would be a sufficient private market to meet the flood

1 Congressional Report, "National Flood Insurance Act of 1967 (H.R. 11197)", regarding hearings before the Subcommittee on Housing of the Committee on Banking and Currency, U.S. House of Representatives, for the dates August 15 and 18; September 19, 20, and 21, 1967, page 3.

insurance demand more efficiently than the federal government. However, the NFIP was created in the first place because the private market had failed to insure flood risk. As a result, federal intervention was and continues to be justified today.

The market failure for flood insurance is one of information and adverse selection. Flood risk is inherently unpredictable, so property owners understandably under- or over-estimate their risk according to a subjective set of probabilities. The owners most likely to purchase flood insurance are also most likely to experience flood loss. Knowing this, private insurers would naturally have to be highly selective of whom and where they insure. In a private market, companies would be able to reject applicants when they do not believe that the potential losses would be offset by the estimated premiums. They would also have to set insurance rates at a level that reflects a pool of insureds that is skewed toward the higher risk properties. That rate would likely be set high enough that even those demanding insurance can no longer afford it, prompting them to opt out and the rate to be increased further to reflect those remaining in the pool. This in turn would cause another round of opts-out and rate increases, and so on.

The existence of this market failure is supported by the market research of RAND[2] and the General Accountability Office (GAO).[3] These studies find limited-to-no private market potential, as there are no governmental or other barriers to prevent private insurers from entering the flood insurance market today. GAO found that merely four large companies write what private flood insurance is offered in the United States. However, these companies write only for owners with "high net worth" and high-value property of "at least $1 million." RAND's analysis reinforced GAO's findings when it found fewer than 200,000 private policies in a market where the NFIP currently writes 5.6 million. Going from 200,000 to 5.6 million private policies would require a market to ramp up by 3,000% to meet the demand in only two short years were H.R. 435 enacted. RAND also surveyed current rates for these private policies and found that the rates ranged from 1.3 to 3.4 times that of "full risk" NFIP premiums depending on flood zone.

Because the private market would bear the full risk if the NFIP is ended, primary insurers would have to cede some of that risk to secondary markets and purchase reinsurance. They would also have to account for additional costs that a federal program would not incur, including taxes, the cost of capital (i.e., the rate of return to attract investors), and the profit paid to shareholders.

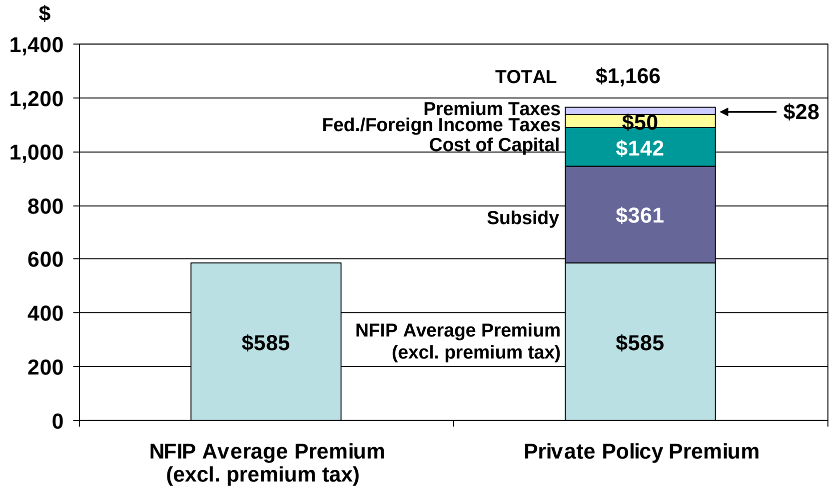
Building on RAND's private-policy rate survey, in a white paper, the Property Casualty Insurance Association of America (PCI) calculated how much the average NFIP premium would have to rise in order to cover these additional expenses.[4] According to PCI, the cost of capital and profit would add from $66 to $410 dollars to the average, depending on flood zone. The additional taxes would add from $23 to $143. Not included in the NFIP premium rate is the amount of the underwriting expense which the NFIP currently passes through to claims adjusters. That amount would also have to be added back at the end and is estimated to range from $13 to $82. In total, the average premium would double from $600 to approximately $1,200 according to PCI's estimates.

2 RAND Corporation, "The Lender Placed Flood Insurance Market for Residential Properties," 2007.

3 The GAO, "Information on Proposed Changes to the National Flood Insurance Program," Letter to Rep. Barney Frank, Report GAO-09-420R, February 27, 2009.

4 Property Casualty Insurers Association, "White Paper: True Market-Risk Rates for Flood Insurance," April, 2011.

Figure 1
Average Private Flood Premium is
Twice as Much as NFIP Premium



Source: PCI, based on NFIP Actuarial Rate Review and other sources

The market cannot guarantee property owners' access to affordable flood insurance. That is simply the nature of a private market. Even if private insurers were able to obtain state-by-state approval to charge rates that are sufficient in the insurer's judgment to manage the additional expense and risk, few property owners (except perhaps the wealthiest) could afford flood insurance at double the average rate. Already less than 50% of those in the 100-year floodplain purchase flood insurance at the NFIP rate. The percentage is much lower for those in areas where flood insurance is voluntary. This helps explains why many primary insurers (which would stand to profit most from privatizing NFIP) have taken a public stand in **opposition** to privatization (e.g., see NAMIC's letter to FEMA dated December 29, 2010). The profit potential is simply not there. Just the potential for negative publicity of likely rate hikes alone would not justify the opportunity for most of these companies.

At the same time, the federal government would still have to assist in community rebuilding efforts after a flood. Imagine if Congress had not responded to TV images of New Orleans families living in makeshift tents in the Superdome after Hurricane Katrina. The amount of federal assistance will not decline if there is no longer an NFIP; the only difference would be in the form of assistance the federal government provides. Rather than authorizing a federal program to collect premiums from property owners to cover their claims in a typical year, Congress would likely have to increase the amount of taxpayer-subsidized SBA loans, grants and public assistance to these communities. By increasing the number of insured properties, the NFIP reduces the number that would have to be rebuilt at taxpayer expense. In fact, the NFIP reduces taxpayer burden by providing an alternative to expensive post-disaster relief.

Myth #2: The NFIP Benefits Coastal States at Non-Coastal States' Expense.

In 2008, a GAO study of NFIP rate setting was supplemented by a state-by-state analysis that added up claim payments and premiums from 1978 to 2007 and then subtracted the total premiums from the total claims.[5] GAO was building on an earlier report by the Congressional Research Service (CRS).[6] Because these analyses showed that some coastal states were receiving more in claims than they paid in premiums over time, some concluded that losses in these states must be cross subsidized by premiums paid in non-coastal states. The argument made was one of lack of fairness that non-coastal states are being forced to pay into a program from which they are getting relatively little in return. One observer likened the NFIP to an "ATM machine" that non-coastal states pay into in order for other states in the path of hurricanes to finance community rebuilding efforts along the coast, which from their point of view, is irresponsible.

However, such judgments are based on one interpretation of partial analyses that were not designed for that purpose. Underlying these judgments are premises that a) some states are facing a higher flood risk and not paying proportionate to risk; b) lower-risk states are making up the difference by paying more than their fair share; and c) historic claims data can be used to identify which states are low risk and cross subsidizing the others. Yet, CRS and GAO were not analyzing the risk to states. Indeed, GAO explicitly acknowledged the limitations of relying on this type of analysis to draw such conclusions:

> "*We recognize that flooding is a highly variable event, with losses varying widely from year to year, and that even an analysis of nearly three decades of historical data could lead to unreliable conclusions about the actual flood risk faced by a given state*." [7]

Rather, CRS was concentrating on the subset of properties with repetitive insured losses under the NFIP. GAO was looking for a pattern in insurance pricing among states with "high-loss" years (i.e., years when a state's annual claims exceeded its premiums). The idea was that if some states frequently had high-loss years, and policyholders in these states were paying the same rates as those in other states, it could raise questions about the NFIP's rate structure.

The fact that certain states have not recently flooded at a magnitude that the total claimed exceeded the amount paid does not prove it never will. As GAO's analysis shows, historically, Louisiana had paid $428 million more in premiums than claims when Hurricane Katrina struck in 2005. Floods are caused by rising rivers, storms, snow melt, *and* man-made problems with construction, development and structures, as well as hurricanes. They have happened in every state, year around *and* just about anywhere and anytime that rain has fell. Their occurrence is inherently difficult, if not impossible to predict. Even a property with a 2% annual risk of flooding has a 50-50 chance of having no flood during a 35-year period. The lack of a flood over this period does not prove that the house will never flood; a 2% annual risk is a very high risk structure. Rather than focusing on the claims history, the more relevant question is which states are more exposed to flooding *today*, and that would depend on a) a state's concentration of the high-risk properties most susceptible to flood damage; and b) how many of these properties have flood insurance to pay for the future damage, rather than taxpayers via federal disaster assistance.

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5 GAO, "Flood Insurance: FEMA's Rate-Setting Process Warrants Attention," Report GAO-09-12 (October 2008), see Table 4.

6 CRS, "Federal Flood Insurance: The Repetitive Loss Problem," Report RL32972, see Appendix C.

7 GAO, Page 25.

Furthermore, while the GAO did adjust for inflation, neither analysis accounted for whether high-loss years corresponded with high-premium years. For example, in the early 1980s, Michigan had several high-loss years in a row according to the FEMA data; in 1980, 1981, 1982, 1985, and again in 1986, the state's claims exceeded its premiums. At this time, Michigan had approximately half the number of policies it does today (13,000 on average from 1980-86 vs. nearly 26,000 in 2009). If the analysis were limited to that time frame, the state would have ranked among the larger net losers to the NFIP. Fortunately, were Michigan to experience a similar level of claims today, the flood risk would be spread out over a larger number of insured properties distributed over a wider geographical area. The 30-year difference, to which the critics point, will not provide a complete picture of state risk.

The GAO did improve on the CRS analysis by also ranking states by the number of high-loss years. If one focuses on states with the highest numbers, one would find that seven of the top 12 were not coastal states at all: Missouri, West Virginia, Illinois, Ohio, Oklahoma, South Dakota and Kansas. At the other end of the spectrum, five of the bottom 12 states (those with the fewest high-loss years) had a coastline: Georgia, Oregon, South Carolina, Florida, and Alaska. For example, not only did Florida's 2 million policyholders pay $10 billion more in premiums than the amount of claims paid out over 30 years but they also saw only one year when their annual claims exceed premiums. Compare that to, say, Illinois with 48,000 policies but nine (9) high-loss years – the seventh highest number in the ranking.

As it noted, the GAO did not include the amount paid to claims adjusters in calculating total premiums minus total claims:

> *"It is important to note that claims equaling premiums in a given year would not indicate a break-even year, because in addition to covering expected claims in a year, a portion of premiums is also intended to cover expenses necessary to operate NFIP."*[8]

By not including the NFIP's administrative expenses in the calculus, any surplus (i.e. when premiums exceed claims) would appear larger than it really was. If we reproduce the GAO's analysis but add two years of FEMA data (2008 and 2009) as well as the administrative expenses to the claim totals before subtracting premiums, Illinois would have 11 high-loss years; Florida would have three. The full results are appended to this testimony.

8 Ibid., p. 24.

Table. Top/Bottom Net-Loss States	
State	Number of Years that Claims Exceeded Premiums 1978-2007
TOP 12	
Missouri	11
West Virginia	11
Mississippi	10
Louisiana	10
Texas	9
Alabama	9
Illinois	9
Ohio	9
New Hampshire	8
Oklahoma	7
South Dakota	7
Kansas	7
BOTTOM 12	
Georgia	3
Utah	2
Wyoming	2
Nevada	2
Vermont	1
Idaho	1
Oregon	1
South Carolina	1
Florida	1
Alaska	0
New Mexico	0
Colorado	0
Source: GAO	

While the number of high-loss years does provide a meaningful data point, the GAO also uses other approaches to analyze whether states are paying more or less than their fair share into the NFIP. As the GAO noted, "Florida, Texas, and Louisiana are among the states with the most NFIP policies, and therefore have a more significant impact on the amount of premiums collected than other states."[9] These states contribute the most to NFIP's overall capacity to offset flood losses nationally in any given year. RAND estimated that although the NFIP's participation rates in flood zones exceeded 60% in the South and West, they are closer to 20% in the Midwest and Northeast.[10] In a separate report,[11] the GAO provided a series of anecdotes, including the following three:

- "The five combined states of Iowa, Michigan, Minnesota, Missouri, and Wisconsin, when compared to Collier County, Florida, had more county flood disaster declarations (2,092 versus 12), significantly more flood claims payments ($704,706,000 versus $12,483,000), and

9 Ibid., page 25.

10 RAND, "The National Flood Insurance Program's Market Penetration Rate: Estimates and Policy Implications." Prepared as part of the 2001-2006 Evaluation of the National Flood Insurance Program, 2006, see Table 4.1.

11 GAO, "Flood Insurance: Options for Addressing the Financial Impact of Subsidized Premium Rates on the National Flood Insurance Program," Report GAO-09-20 (November, 2008).

a much larger population (28,906,000 versus 297,000), but a similar number of NFIP policies (80,572 versus 85,246)….

- "….Wisconsin, when compared to Rhode Island, had many more county flood disaster declarations (276 versus 11), but had similar flood claims payments ($32,693,000 versus $34,219,000). Even though Wisconsin has a much larger population (5,479,000 versus 1,012,000), it has a similar number of NFIP policies (12,945 versus 14,432)….

- "….The four combined states of Kansas, Nebraska, South Dakota, and North Dakota, when compared to Oregon, had more county flood disaster declarations (1,346 versus 124) and three times more in flood claims payments ($244,828,499 vs. $76,727,971), but a similar number of policies (30,683 versus 29,780) for a much larger population (6,009,000 versus 3,613,000)."

From the same report, GAO found 66 counties where there had been at least one major flood at a magnitude to prompt a presidential disaster declaration, yet none of these communities were participating in the NFIP, such as:

- "Winneshiek County, Iowa (population 21,188) has had seven flood declarations.

- "Adair County, Kentucky (population 17,575) has had six flood declarations.

- "Dallas County, Missouri (population 16,328) has had eight flood declarations."

These anecdotes raise legitimate questions about which states are shouldering their fair share of a flood burden borne by taxpayers and warrant a more systematic analysis.

Geographically, flood disasters are distributed fairly evenly across the United States. Using the number of presidential flood disaster declarations from 1990 to 2005 as a proxy, GAO color-coded a U.S. map (appended to this testimony) illustrating this.[12] Areas in orange, where there have been 6-10 declarations, pervaded every region of the country except the Mountain States. However, a large percentage of these mountainous regions have been designated public lands, so flooding may have occurred there too, but just not yet in a populated area or at a magnitude that prompted a major declaration. That could change. For example, Montana's governor declared a statewide flood emergency just a few weeks ago, where flood watches were issued for 13 Montana and Wyoming counties.[13] If, alternatively, one were to consider only populated areas, 97% of U.S. population lived in a county where at least one declaration was issued between 1990 and 2005. Nearly half experienced six or more major flood disasters.

It is true that many of these declarations occurred in coastal states but most high-risk areas are off-limits to the NFIP under the Coastal Barrier Resources Act of 1982. In the few coastal exceptions

12 GAO, "Natural Hazard Mitigation: Various Mitigation Efforts Exist, but Federal Efforts Do Not Provide a Comprehensive Strategic Framework," Report GAO-07-403 (August 2007), Figure 1.

13 USA Today, "Flooding cuts off Montana town" (May 24, 2011).

areas (designated "V zones"), the number of policies represented less than 2% of all NFIP policies in force from 1997 to 2006.[14]

Table. Number of Policies in Force by Flood Zone, 1997-2006					
	HIGH RISK		MODERATE-TO-		
	Coastal	NonCoastal	LOW-RISK		V zone policies
Year	(zone V)	(zone A)	(zones B, C, X)	TOTAL	As % of Total
1997	79,393	2,703,350	1,151,375	3,962,077	2.0%
1998	84,332	2,801,370	1,199,032	4,114,319	2.0%
1999	84,391	2,872,625	1,220,851	4,206,914	2.0%
2000	82,481	2,904,796	1,239,448	4,255,425	1.9%
2001	82,737	2,931,474	1,309,200	4,360,678	1.9%
2002	84,876	2,970,972	1,313,551	4,406,664	1.9%
2003	83,668	3,025,121	1,299,483	4,447,774	1.9%
2004	83,946	3,126,322	1,320,107	4,558,696	1.8%
2005	87,148	3,210,442	1,496,359	4,827,179	1.8%
2006	105,183	3,350,209	1,889,242	5,404,952	1.9%

In other words, 98% of NFIP policies were issued inland in such areas as the Red River Valley (between North Dakota and Minnesota) where 2010 saw that river's fifth major flood in a decade and 2009 broke the cresting record set more than 100 years before. Fargo, ND, in particular, has had nine "10-year floods" – i.e., floods that are expected to occur only once every 10 years—during the last 20 years, including one last March. There was a 100-year flood in 2009.15

Historically some of the worst flooding has occurred along rivers, not coasts. For example, the Midwest Flood of 2008 caused 24 deaths and cost $15 billion in property. The Midwest Flood of 1993 cost more than twice that in both loss of life and property (48 deaths, $30 billion) and continues today to be one of the most expensive disasters in U.S. history.[16]

In summary, while some may assert there is a cross subsidy from non-coastal to coastal states based on an interpretation of what the authors consider to be a partial and inconclusive analysis of the NFIP, the weight of data does not support the conclusion. Analyses of the number of high-loss years by state, loss history of states with similar NFIP policy numbers, NFIP participation rates by region, the U.S. distribution of flood loss geographically and by population, and the fraction of NFIP policies in coastal versus non-coastal high-risk areas – all point in the opposite direction.

Myth #3: NFIP Debt and Repeated Pay-outs Cost Taxpayers Money.

14 GAO, "NFIP: Financial Challenges Underscore Need for Improved Oversight of Mitigation Programs and Key Contracts," Report GAO-08-437 (June 2008), see Table 18.

15 Center for American Progress, "The Year of Living Dangerously: 2010 Extreme Weather Costs Lives, Health, Economy," (April 2011) pp. 8-9.

16 Lott, N., Ross, T., Houston, T., and A. Smith, 2010: "Billion dollar U.S. weather disasters, 1980-2010. Factsheet". [NOAA National Climatic Data Center, Asheville, NC, 3 pp.]

Recent reports have called attention to the NFIP's debt and repeated pay-outs for some properties.[17] The implication is this program is costing taxpayers' money. While citing a $17-billion-dollar debt and a property that has received more in claims than the value of the property may provide for eye-catching headlines and certainly sounds sensational, the truth does not lend itself to a sound bite.

The Congressional Budget Office (CBO) recently evaluated legislation to reauthorize the NFIP for five years and found zero budgetary impacts. Of the "Flood Insurance Reform Priorities Act of 2010" (H.R. 5114), the CBO concluded:

> *"Under both current law and under this legislation, CBO estimates that the NFIP could continue to make timely payments on valid flood insurance claims until the program's remaining authority to borrow from the Treasury is exhausted. Because provisions affecting premium income would have a minimal effect prior to the time the program exhausts the remaining borrowing authority (which, CBO estimates, would occur in 2013), we estimate that those changes would have no net effect on direct spending over the next 10 years….CBO estimates that the changes made to the NFIP by H.R. 5114 would yield additional premium income of $2.8 billion for insurance policies that FEMA can offer under current law. However, CBO estimates that those receipts would be spent to pay insurance claims expected under current law, resulting in no net change to direct spending over the 2011-2020 period."*

Reauthorizing the NFIP would not increase direct spending or add to the Federal Budget Deficit.

Historically, the NFIP has collected enough in premiums to pay the claims and expenses in most years. In the few instances when it did borrow from the U.S. Treasury, the program quickly repaid the loan in full with interest.[18] Such borrowing does not translate into higher taxes. For use of these funds that would otherwise be freed up for other uses, the Treasury charges an interest rate. Once the NFIP pays off the loan, taxpayers would lose the forgone interest.

However, 2005 was an outlier storm year, shattering numerous records (including most Category 5 hurricanes in a single season) and raising the prospects that the NFIP would not be able payoff the most recent loan in the near future. For 2005 and subsequently Ike and the 2008 Midwest Floods, the outstanding balance now stands at $17.5 billion. According to FEMA, this is an amount greater than the sum of all previous losses since the NFIP's inception in 1968.

CBO did estimate that the remaining borrowing authority for the NFIP would be exhausted in 2013, which is not captured in the standard budget presentation on a year-by-year cash basis.[19] However, this would not add to the Federal Budget Deficit either. As CBO put it,

> *"At that point [when borrowing authority exhausts], net spending for the program will be zero—payments would be limited to amounts deposited into the NFIP through premium and fee income, and additional borrowing would not be available. Thus, expenses exceeding NFIP deposits in a given year would be paid at a later date upon collection of future receipts."*

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17 For example please see USA Today, "Huge Losses Put Federal Flood Insurance Plan in Red" (August 26, 2010).

18 Congressional Research Service, "NFIP: Treasury Borrowing in the Aftermath of Hurricane Katrina," Order Code RS22394 (June 6, 2006), page 3

19 CBO, "Budgetary Treatment of Subsidies in the NFIP," Testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (January 25, 2006).

As for the "Repetitive Loss Properties" – the properties referenced in news reports that have received more in payouts than the property's value, we note that Congress previously addressed them once before. Under the Severe Repetitive Loss program established by the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 (42 USC 4102A), owners of these properties were supposed to be presented with an offer to mitigate (or strengthen) their property against future flood risk. If the owner refused, upon future claims, the owner would see rate increases until the premium reached the full risk (actuarial) level. Yet, the mitigation program was not fully funded. While the statute is clear on the consequences of refusing a mitigation offer, it is more ambiguous about what happens when the owner simply chooses not to respond. Congress can and should take immediate, further action to address these properties that represent only 1% of NFIP properties but 30% of claims.

NAR strongly supports reforms to ensure that repetitive loss properties pay the full-risk rate and urges Congress to make the technical corrections and appropriations necessary for an effective mitigation program.

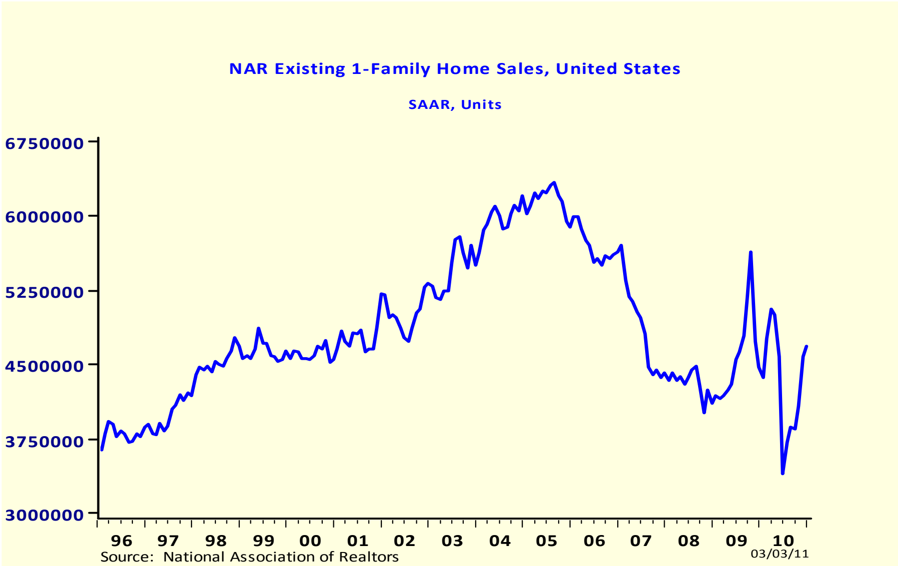
Proposed Legislative Reforms

In the 110th Congress, the Senate Banking Committee reported S. 2284, the Flood Insurance Reform and Modernization Act. While we continue to have concerns with some of the provisions, NAR strongly supports the bill's overall approach of reauthorizing NFIP for a full five-year term before the current deadline of September 30, 2011. We also support the goal of strengthening the NFIP's long-run fiscal solvency and welcome the opportunity to work with the Committee to achieve this goal. We note that a 5-year reform bill, H.R. 1309: the Flood Insurance Reform Act, was also recently approved by the unanimous, bipartisan vote of the House Financial Services, and is awaiting consideration by the House in the near future. Following are NAR comments on provisions which could be included in a potential Senate version of this legislation.

Extension of NFIP Authority

The Senate bill (S. 2284) would have reauthorized the NFIP for a full five-year term, and NAR strongly supports including such a provision in the next NFIP reform bill. We believe that five years is the minimum necessary to provide some certainty for the real estate markets to recover.

The housing market continues to recover from the longest recession since World War II. Home prices remain weak as distressed properties make up a significant portion of home sales. Many home buyers, who bought during the peak of the market, continue to be underwater and face foreclosures. The weak job market is also putting negative pressure on the housing market. Below is NAR's chart of existing home sales. While affordability remains strong and home sales are showing some signs of stabilization, the housing market is in a precarious position and cannot afford any further negative shocks.



The commercial real estate market is similarly struggling amid the greatest liquidity crisis since the Great Depression. Due to the economic downturn, commercial property values have fallen 43 percent across the board from their peak in 2007. Often it is the owner of America's small businesses -- the very engine of job creation and innovation and the backbone of his or her local community -- which has suffered most. Compounded with nearly $2.2 trillion in commercial real estate loans coming due over the next decade, and a very limited capacity to refinance, the sales and leasing of commercial properties have been dismal, hindering our nation's economic recovery. Failing to reauthorize the NFIP long-term not only exacerbates the market uncertainties but also could leave many commercial property owners, many of whom are struggling to stay afloat due to high vacancy rates and lower net operating incomes, without access to affordable flood insurance. The lack of available, affordable flood insurance for property owners, in many cases, would hold up the sale of commercial properties, further contributing to the economic crisis.

Flood Mapping Reforms

The Senate bill would have:

- Established a Technical Mapping Advisory Council to review and make recommendations for more accurate flood insurance rate maps; such maps are used to determine which properties are located in "Special Flood Hazard Areas" (SFHAs) and thus subject to the mandatory purchase of flood insurance.

- Directed FEMA, in coordination with the Council, to update the flood maps and include the 500-year floodplain and the areas of residual risk (behind levees, dams or other man-made structures) in addition to the 100-year floodplain.

NAR Comments: FEMA recently completed a 10-year map modernization initiative to update the flood maps. These updates capitalized on major advances in modern flood mapping technologies including LIDAR and satellite imaging. While survey data shows only a fraction of property loans (e.g., <3% in 2009) were affected by these revisions and of those affected, about as many were removed from SFHAs as the reverse, concerns continue to be raised about the accuracy of these maps.[20]

NAR generally supports efforts to improve the accuracy of the flood maps. Reestablishing the technical mapping advisory council of independent experts would help strengthen the scientific integrity underpinning these maps and increase confidence in their development. We also believe that to effectively meet its charge, the Council must include a real estate expert as a member.

At the same time, we would oppose expanding flood maps to include areas outside of the 100-year floodplain. The very inclusion of bill provisions to improve map accuracy implies that at least some maps are not now accurate. If so, FEMA should focus its limited resources on drawing an accurate 100-year floodplain before being required to redraw and expand the boundaries to include the 500-year floodplain or residual-risk areas. (Please note the latest House Committee bill (H.R. 1309) originally included a provision to also delineate the 250-year floodplain, but that provision was struck during the markup.)

In most cases, the resolution and thus accuracy of the mapping technologies significantly improved. Yet, there may still be a few exception areas where the resolution was not sufficient to detect some properties that sit on natural ground above the 100-year floodplain or a property may also have been built on fill material after FEMA's modernization project began. In either case, such property owners may appeal, which would require analysis and documentation by an engineer that could be time consuming and expensive. Risk determinations would be made based on sound technical assessments involving engineering, topography and hydrology. We would encourage the Senate to include provisions to streamline the flood map appeals process to address any inaccuracies in a flood map. The House Committee also amended its bill to provide for the reimbursement of expenses in the event of a successful map appeal, and we would encourage the Senate Committee to consider including a similar provision in its bill as well.

Newly Flood Mapped Areas

The Senate bill would have subjected areas of residual risk (behind levees, dams, and other manmade structures) to the mandatory purchase of flood insurance requirement.

NAR comment: FEMA has not been able to assure the accuracy of the boundaries it's drawn around the 100-year floodplain. Directing FEMA to expand these boundaries now would only compound the problem. In addition, there are numerous smaller levees, berms and other structures all over the country that could be considered flood control structures, which would diminish the flood risk and therefore the insurance rate to be charged. We are not aware of any assessment of these structures or the economic impact of expanding the mandatory purchase requirement to property owners near them. We would not recommend including these provisions in the latest bill. Before proceeding, GAO should conduct a study of the number of flood control structures, the average premium that would be charged behind these structures and the resulting economic impact on property owners.

The House Committee bill also included authority for FEMA to suspend for 12 months (and extend for up to two more 12-month periods) the mandatory purchase requirement for communities which

20 Communication with National Flood Determination Association, May 24, 2011. Based on NFDA's annual surveys from 2006 to 2010, which represent 94% of the market that completes flood zone determinations.

are newly included in the 100-year floodplain but where the area has had no flood history; was in the process of appealing the new map; or been making progress toward improving a structure that protects against flooding such as a levee or dam.

We believe it reasonable to delay the flood insurance mandate while the communities work through appeals over inaccurate maps, and we would respectfully request the inclusion of similar provisions. Otherwise, property owners could be forced to purchase flood insurance only to find months later that the requirement was a mistake. Then these owners would be in the position of having to seek reimbursement for the purchase of insurance they never should have been required to purchase in the first place.

We would also request that the Committee streamline the flood map appeals process for communities as well as individuals. Currently, individual property owners may face significant transaction costs in coordinating appeals across properties and have little choice but to turn to the community. Community appeals could involve considerable tax dollars to hire the experts necessary to conduct and make the reasonable judgments that go into a dueling engineering study with FEMA's. If FEMA's mapping process is inaccurate, the burden should be placed back on FEMA to correct the maps—not shifted forward to the property owners or communities that have been incorrectly drawn into the 100-year floodplain.

Premium Rate Reforms

The Senate bill included provisions to:

- Authorize an annual premium increase of up to a maximum of 15% per year.
- Set minimum deductibles for newer and older properties.
- Phase-in the full actuarial rate by 50% per year over two years for properties in newly flood mapped areas.
- Phase-in the full rate (by 25% a year until the full-risk rate is achieved) for older properties including:
  - Business Properties;
  - Non-primary Residences;
  - Homes Substantially Damaged or Improved; and
  - Severe Repetitive Loss Properties.
- Prohibit the extension of subsidized rates for new or lapsed NFIP policies.
- Direct FEMA to include "catastrophic loss years" in calculating the "average historical loss year;" FEMA sets the premium rates annually to cover this average.
- Establish a Reserve Fund for catastrophic loss years to be funded by a surcharge on flood insurance policies.

NAR Comments: In order to preserve the federal flood insurance program into the future, the real estate sector recognizes the need for everyone to shoulder their fair share, even if it means paying a little more. The severe repetitive loss properties, accounting for 1% of NFIP properties but 30% of claims, are a particular budgetary challenge for the NFIP. Therefore, we would strongly support charging such properties the full actuarial rate. However, we would continue to have concerns with applying these provisions to other older properties where there has been no history of flood loss or change in risk.

Congress grandfathered older properties under a lesser rate because it was believed to be better to include these properties in a program where they could be strengthened against future flood loss, even if it meant they paid a little less. This was so that the U.S. taxpayer would not ultimately end up footing the bill for rebuilding those properties after the next flood. Under the Senate bill however, these owners, who may have been contributing considerable premium dollars to the NFIP for decades, would now have to pay significantly more, not because there has been a flood loss or even a change in their flood risk; but rather because the property is not the owner's primary residence (i.e., it's a business property or non-primary residence).

According to FEMA, on average, premiums charged for subsidized policies are about 35-40% of their full-risk level. Thus the average premium would have to increase to about two and a half times the current level under the proposed increase. This is for the average premium; some properties could see the premium increase more than four-fold. There is a limit to the amount that the insurance, or any other expense, may increase before owners are either forced to sell their properties, or go without insurance. This would have a particularly severe impact on the cost of home ownership and rents, especially in older communities and those that rely on tourism. This could lead to additional rounds of delinquencies, foreclosures and reduced property tax bases in these communities.

While we continue to have concerns about the affordability of the proposed insurance rates for older properties, particularly those with no history of flooding or change in risk, at minimum, we would respectfully request that the Committee:

1) Phase-in any rate increase more gradually than the last Senate bill so that every owner has an opportunity to adjust to the increases and no one has to shoulder the entire increase in a single year. (Note: The House bill would phase-in the full rate for most of the older properties over at least a 5-year timeframe.)

2) Provide the same gradual phase-in for all categories of older and newly mapped properties that are subject to a rate increase. Every affected owner should have the same opportunity to adjust.

3) Separate out multi-family rental properties of four or more units from the non-residential properties and exclude them from the phase-in, due to affordability concerns. For the renter, the apartment or house in which he or she is living is the primary residence, but could be considered either a commercial property or a non-primary residence because it is non-owner-occupied. Thus, if the discounted rate were eliminated, tenants would face rent increases that would have a dramatic effect on housing affordability, especially in the case of low and fixed-income individuals and families.

4) Continue to include comprehensive coverage for all properties, including multi-family housing, non-primary residential and commercial properties.

5) Not adopt "back-door" rate increases for NFIP property owners. Requiring FEMA to recalculate the "average historical loss year" to include "catastrophic loss years" is simply another way to raise rates, except this way would be less transparent to the property owner. This is because FEMA sets premium rates to cover losses in the historical average year. By including outlier years in this calculation, as this amendment would, this would inflate the amount the rate would have to cover and therefore the rate itself. We believe that a reserve fund is a more straightforward way to offset the losses in catastrophic years (for more on the bill's reserve fund provisions, please see below).

6) Study the impact of any rate phase-in on pre-FIRM properties so that the Congress would have a basis to evaluate and adjust the phase-in as necessary.

While we would support establishing a reserve fund to cover above-average loss years, we would like to work with the Committee to ensure that such a fund would not reduce voluntary NFIP participation. The last Senate bill would have required FEMA to build up the fund by annually putting in hundreds of millions of dollars until an amount numbering in the billions was reached. As a result, FEMA would have had to raise rates somewhere in order to meet this annual quota, however it could not have looked to property owners who were already experiencing rate increases near the annual limitation. Instead it would have had to look those who were voluntarily participating in the program which could undercut future participation. We encourage Congress to ensure that all participants are treated fairly and equitably as the reserve fund is created.

Coverage Term Reforms

The latest House Committee bill would provide optional coverage for business interruption and living expenses at the full actuarial rate and only if there is not a market for the coverage and it will not lead to additional borrowing. Adding these options to the Senate bill would attract new NFIP participants. That would lead to increased funds for the NFIP, help property owners recover from flood losses and decrease future federal assistance when under-insured properties flood and suffer loss. It would also help increase protection for home- and small-business owners. Increasing or indexing the maximum coverage limits, also as the House committee bill would, would ensure these limits more accurately reflect the increases in property and contents values and provide fuller coverage to policyholders. These limits have not been adjusted despite inflation since 1994. We would ask the Committee to consider including these provisions.

Privatization Initiatives

The House Committee bill includes studies by FEMA and GAO to begin the process of privatizing the NFIP after the 5-year reauthorization. The last Senate bill did not include such provisions.

NAR Comments: NAR is adamantly opposed to any effort to move the NFIP towards privatization, including a pilot program or other initiative. We established in previous sections that the private market could neither guarantee the availability nor the affordability of property insurance to protect against flooding, one of the most expensive natural disasters in the United States. Privatizing the NFIP would only remove a sole alternative to taxpayer-funded government payments for rebuilding after a major flood. Now is not the time to experiment with real estate markets that are recovering from the worst economic downturn since the Great Depression. We urge the Committee not to include similar provisions in a Senate bill.

Natural Disaster Commission

The Senate version of H.R. 3121 in the 110th Congress included provisions to establish a commission on natural catastrophe risk management and insurance. This commission would be charged with examining the risk to the United States posed by a broader range of natural disasters (other than floods) and to make recommendations to Congress for mitigating the risk.

NAR comment: We applaud the Senate for including this commission in its last NFIP reform bill. As stated earlier, today the United States lacks a forward-looking and comprehensive public policy toward natural disasters, except floods, and is one natural disaster away from a budgetary nightmare. REALTORS® strongly believe that ensuring access to affordable property insurance for all natural disasters is an indispensible component of any forward-looking policy. Such a policy has the potential to save billions of taxpayer dollars annually by shifting the costs of rebuilding under-insured communities following a natural disaster back to affected property owners who would now have been able to buy insurance and protect themselves in advance of these disasters. NAR strongly supports these commission provisions and would encourage the Committee to include them in its version of NFIP reform legislation.

Conclusion

In summary, the NFIP fills a void in the private market for critical insurance protections against flood losses which benefit the nation as a whole. While the Committee is facing difficult reform choices, proceeding is preferable to the current month-to-month stop-gap extension approach which has only undermined confidence and exacerbated uncertainty in recovering real estate markets. Thank you again for the opportunity to share the REALTOR® community's views on the importance of the NFIP. NAR stands ready to work with the Committee to develop meaningful reforms to the NFIP that help protect property owners and renters and help them prepare for and recover from future losses resulting from floods.

Table. Ranking of States By Number of Net-Loss Years	
	Number of Years that Claims & Expenses Exceeded
State	Premiums 1978-2009
Minnesota	13
Missouri	13
Ohio	13
Louisiana	12
Mississippi	12
West Virginia	12
Alabama	11
Illinois	11
Texas	11
Arkansas	10
Kentucky	10
New York	10
Indiana	9
North Dakota	9
Oklahoma	9
Tennessee	9
Washington	9
New Hampshire	8
Connecticut	7
Kansas	7
North Carolina	7
Pennsylvania	7
South Dakota	7
Virginia	7
Massachusetts	6
Delaware	5
Georgia	5
Iowa	5
Maine	5
Maryland	5
District Columbia	5
Michigan	5
Montana	5
New Jersey	5
Rhode Island	5
Wisconsin	5
Arizona	4
California	4
Florida	3
Hawaii	3
Nebraska	3
Utah	3
Nevada	2
Oregon	2
Vermont	2
Wyoming	2
Alaska	1
Idaho	1
South Carolina	1
Colorado	0
New Mexico	0

Figure 1: Number of Major Flood Disaster Declarations by County, 1980-2005