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TESTIMONY OF

TERRY SULLIVAN
SULLIVAN REALTY, INC.

ON BEHALF OF

THE NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMITTEE ON INSURANCE, HOUSING, AND COMMUNITY OPPORTUNITY

HEARING REGARDING

LEGISLATIVE PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM

MARCH 11, 2011

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Introduction

Chairwoman Biggert, Ranking Member Gutierrez, and members of the Subcommittee, on behalf of the more than 1.1 million REALTORS® who are engaged in all aspects of the residential and commercial real estate sector, thank you for inviting me to testify today regarding draft legislative proposals to reform the National Flood Insurance Program (NFIP).

My name is Terry Sullivan. A REALTOR® since 1970, I am broker/owner of Sullivan Realty Inc. in Spokane, Washington. For most of my professional career I have been involved in land development as well as residential real estate. I have also been active within the National Association of REALTORS® (NAR) for 17 years, holding significant positions at both the state and national levels. Since 1994, I have been a member of the NAR Board of Directors and served as President of the Washington State Association in 2006. Currently I serve as chair of NAR's Land Use Committee which has jurisdiction over the NFIP.

The NFIP ensures access to affordable flood insurance for 5.6 million American home- and business owners. This protection is vitally important as annual flooding claims dozens of lives and billions of dollars in property loss, making it the most common natural disaster in the United States. By law, flood insurance is required 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 property and money.

NAR strongly supports the provision of the draft bill to reauthorize the NFIP for a full five years, ending the current stopgap approach that has only exacerbated uncertainty in recovering real estate markets. Since September 2008, authority for the NFIP has been extended **nine** times and **twice** was allowed to expire for multiple weeks at a time, immeasurably shaking consumer confidence. In June 2010 alone, this resulted in the delay or cancellation of 47,000 home sales according to NAR survey data. While we do have concerns with some of the draft's reforms, we support the Subcommittee's overall approach to reauthorize the program long-term before current authority is set to expire on September 30 of this year and share the goal of strengthening the long-term viability of this critical program.

Before turning to specific reforms, I would like to address several common myths about the NFIP as well as its legislative history. 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. Data also does not support assertions of a cross subsidy from non-coastal to coastal states nor a cost to taxpayers from reauthorizing the NFIP. The private market would guarantee neither the availability nor the affordability of flood insurance along rivers, the relatively few coastal areas where NFIP is legally permitted, or anywhere else that rain falls. Without this program, the only way for many owners to rebuild after a flood would be for the federal government to provide post-disaster rebuilding assistance – using taxpayer dollars.

Legislative History

The NFIP was created in 1968 after Hurricane Betsy because there was no market alternative for flood insurance. Historically, most communities were built along rivers as well as coastlines. Because flood victims could not turn to a private market to insure and pre-pay for the flood damage,

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 with yet another 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 is 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 program shave 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 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 again on the verge of approving a subsequent bill (H.R. 3121, the Flood Insurance Reform and Modernization Act), but did not hold a conference as attention turned to the problems facing the U.S. financial system. We thank the members of the House of Representatives, and particularly this subcommittee, for returning to the subject in the last Congress, by approving the Flood Insurance Reform Priorities bill, H.R. 5114. Ultimately the 111th Congress failed to complete its work on the legislation and the NFIP's authority had to be extended for the ninth time, following a total of five lapses since 2008, and two just last year for several weeks each lapse. At this time, the program is again set to expire on September 30th of this year.

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.

Common Myths

Before turning to the draft reform bill, I would like to address several misconceptions about the NFIP. 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 along rivers, the relatively few coastal areas where NFIP is legally permitted, or anywhere else that rain falls. 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 taxpayer-funded disaster relief.

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

H.R. 435, legislation to terminate the NFIP by 2013, has been introduced by Rep. Miller of Michigan. 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 insurance demand more efficiently than the federal government can. However, the NFIP was created in the first place because the private market failed. 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.

This 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 3000% 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.

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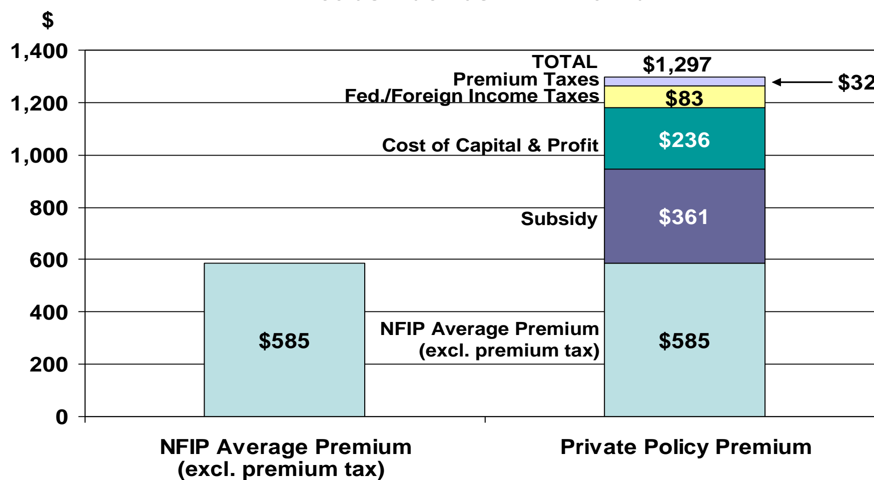
2 RAND Corporation, "The Lender Placed Flood Insurance Market for Residential Properties," 2007.

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.

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 – costs 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, 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 $110 to $683 dollars to the average, depending on flood zone. The additional taxes would add from $39 to $239. 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 $15 to $92. In total, the average premium would more than double to approximately $1,300 from $600 according to the PCI's estimates.



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 the wealthiest) could afford flood insurance at more than double the average rate. Already fewer 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 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

4 Property Casualty Insurers Association, "True Market-Risk Rates for Flood Insurance," March 7, 2011.

would not decline; 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 self-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 and financial assistance.

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

In 2008, a GAO study of NFIP rates was supplemented by a state-by-state analysis which summed claim payments and premiums from 1978 to 2007 and then subtracted total premiums from total claims.[5] Because this supplemental analysis also showed that some coastal states were receiving more in claims than they paid in premiums over 30 years, others concluded that losses in these states must have been offset by the premiums paid in non-coastal states. The argument is one of fairness that non-coastal states are being forced to pay into a program from which they are getting relatively little in return. One 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 an interpretation of a partial analysis that was not designed for that purpose. Rather, the GAO was looking for a pattern among states with "high-loss" years (i.e., years when a state's annual claims exceeded its premiums). 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 GAO explicitly acknowledged the limitations of relying on this partial analysis to draw conclusions about whether states are paying their fair share of the flood risk:

> "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." [6]

While the GAO did adjust for inflation, the analysis did not account for whether high-loss years corresponded with high-premium years. FEMA data shows that in the early 1980s, Michigan, for example, had several high-loss years in a row: in 1980, 1981, 1982, 1985, and again in 1986, the state's claims exceeded its premiums. This was around a time when Michigan had approximately half the policies it does today (13,000 on average from 1980-86 vs. nearly 26,000 in 2009). Were Michigan to experience a similar amount of claim payments today, the risk would be spread out over a larger number of insured properties distributed over a wider geographical area. A 30-year total would not provide a complete picture of this. It would not show which states are less (or more) exposed to flood risk today versus yesterday.

The GAO analysis ranked 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

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

6 Ibid., Page 25.

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.

Also 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."[7]

By not including the NFIP's administrative expenses in the calculus, any surplus (when the 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) and 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.

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	

7 Ibid., p. 24.

While the number of high-loss years provides 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."[8] These states contribute way more than others to the NFIP's overall capacity to offset flood losses nationwide in a given year. RAND had already estimated that although the NFIP's participation rates in flood zones exceed 60% in the South and West, they are closer to 20% in the Midwest and Northeast.[9] In a separate report,[10] 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 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 losses are distributed fairly evenly across United States. Using the number of presidential flood disaster declarations from 1990 to 2005 as a proxy, the GAO color-coded a map

8 Ibid., page 25.

9 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.

10 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).

of the United States (appended to this testimony).[11] This map reveals that areas in orange (where there were 6-10 declarations) pervaded every region of the country except Mountain States. However, a large percentage of these mountainous areas have been designated public lands so flooding may have occurred there, just not in a populated area or not yet at a magnitude to prompt a major declaration. If, alternatively, one considers 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 areas (designated "V zones"), the number of policies represented less than 2% of all NFIP policies in force from 1997 to 2006.[12]

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. 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.[13]

In summary, while some may believe there is a cross subsidy from non-coastal to coastal states based on one interpretation of what the authors consider a partial and inconclusive analysis of the NFIP, the weight of data does not support the conclusion. Analyses of the number of high-loss

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11 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.

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

13 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.]

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.

Recent reports have called attention to the NFIP's debt and repeated pay-outs for some properties (e.g., see USA Today, "Huge Losses Put Federal Flood Insurance Plan in Red" (August 26, 2010)). 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 (0) 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 paid back the loan in full with interest.[14] Such borrowing does not translate into higher taxes. For use of the funds that would otherwise be freed up for other uses, the Treasury charges interest at a current annual rate of 0.25%. Once the NFIP pays off a loan, taxpayers 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.

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

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.[15] 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."

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

Before the Subcommittee is a discussion draft of legislation titled the "The Flood Insurance Reform Act of 2011." NAR strongly supports the provision to reauthorize the NFIP for a full five years, ending the current stopgap approach that has led to nine extensions and five lapses of program authority since 2008. Two of these lapses immeasurably undermined real estate investor confidence. In June 2010 alone, one lapse resulted in the delay or cancellation of 47,000 home sales according to NAR survey data. While we do have concerns with some of the draft's reforms, we support the Subcommittee's overall approach to reauthorize the program long-term before current authority expires on September 30 of this year and share the goal of strengthening the long-term viability of this critical program. Below we provide a description of each section of the draft followed by NAR's comments.

<u>Section 2: Extensions.</u>

This provision would reauthorize the NFIP through September 30, 2016.

NAR Comments: We strongly support this provision. We believe that a reauthorization for a minimum of 5 years would provide needed certainty for real estate markets to recover.

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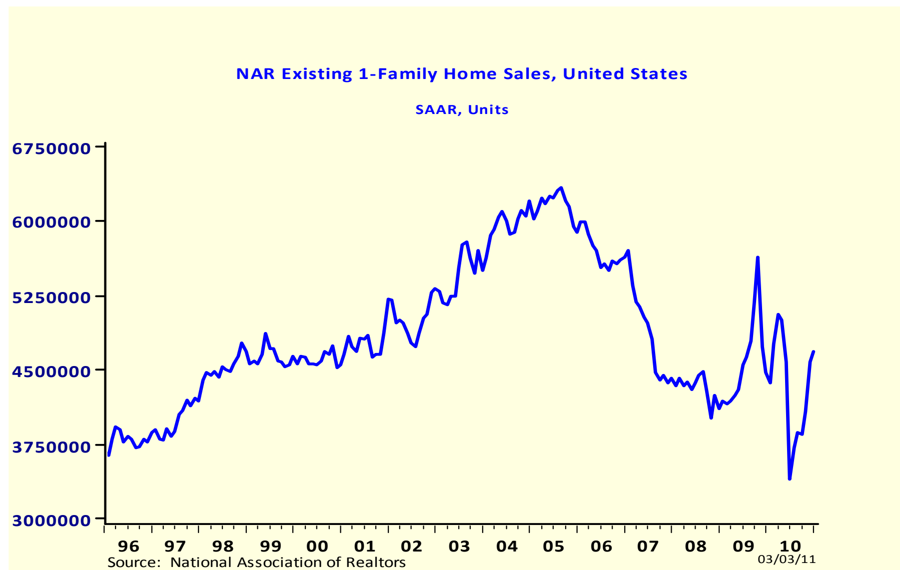
15 CBO, "Budgetary Treatment of Subsidies in the NFIP," Testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (January 25, 2006)

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.

Section 3: Mandatory Purchase.

These provisions would authorize FEMA to suspend for 12 months (and extend for up to two more 12-month periods) the federal mandate to purchase flood insurance in communities that are newly included in the 100-year floodplain. To be eligible, these communities must be:

- In an area where there has been no history of flooding;
- In the process of appealing a new floodplain map (where the insurance is required); or

- Making progress toward improving a flood protection system, such as a levee or dam.

While during a delay, the federal mandate would not apply, the language explicitly provides the lender or servicer discretion to itself require flood insurance to obtain a loan. It would also terminate and refund "force placed" insurance (i.e., insurance that is bought and placed by the lender and imposed on the borrower to pay).

NAR Comments: It is reasonable to delay the flood insurance mandate while the communities work through appeals over either the accuracy of new floodplain maps or the re-designation of areas as a 100- year floodplain while the community is still improving a system that protects those areas from a 100-year flood. However, we question whether this section would effectively establish a moratorium for the purchase of flood insurance for most property owners in areas newly covered by flood maps, because lenders may still require it as a condition of the loan. Lenders are likely to insist on protecting the security for the loan by either requiring the homeowner to purchase flood insurance, or even if this is prohibited by law, by refusing to make loans for properties in newly designated floodplains. Further, if a lender seeks to securitize a mortgage by selling it to an issuer of a mortgage-backed security, flood insurance would likely be required in order to make the security marketable to investors.

We would urge the Subcommittee to streamline the flood mapping appeals process for obtaining a letter of map amendment or revision. Currently, individual property owners may face significant transaction costs in coordinating appeals across many properties. Communities may also appeal but that would 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 to the property owners or communities that have been incorrectly drawn into the 100-year floodplain.

Section 4: Reforms of Coverage Terms.

These provisions would:

- Set a minimum annual deductible both for properties paying a subsidized premium rate and those paying the full risk (actuarial) rate;
- Index coverage limits annually based on the previous year's inflation beginning in 2012;
- Provide optional coverage for loss of use of the residence or business interruption at the full-risk rate if there is not a market for the coverage and it will not lead to additional borrowing; and
- Provide for residential rate increases/fees to be paid in quarterly installments.

NAR Comments: We support provisions to index or expand coverage to encourage participation in the NFIP. Increasing participation 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. Adding options for living expenses, basement improvements, and the replacement cost of contents would also help increase protection for home- and small-business owners. Increasing the coverage limits, which have not been adjusted despite inflation since 1994,

would more accurately reflect increases in property and contents values and provide fuller coverage to policyholders. Setting minimum deductibles to improve the long-term solvency of the financial program is reasonable. Allowing residents to pay in installments could help with the affordability of rate increase under the NFIP.

Section 5. Reforms of Premium Rates.

These provisions would:

- Authorize an annual premium increase of up to a maximum of 20% per year.
- Phase-in the full-risk rate for properties newly mapped into the 100 year floodplain. The rate would increase by 50% in the initial year and by 20% each year thereafter until the full-risk rate is reached.
- Phases-in the full rate (by 20% a year until the full-risk rate is achieved) for the following categories of subsidized property:
    - Non-residential Properties;
    - Non-primary Residences (includes multi-family);
    - Primary Residences at Sale;
    - Homes Substantially Damaged or Improved; and
    - Homes with Multiple Claims.
- Prohibits extension of subsidized rates for lapsed NFIP policies.

NAR Comments: We would support increasing to the full risk (actuarial) rate properties that have a demonstrated history of flood loss. In particular, the repetitive loss properties (addressed under "homes with multiple claims") have been estimated to account for 1% of NFIP properties but 30% of claims. In addition, we would also encourage the Subcommittee to strengthen the Severe Repetitive Loss program to ensure such properties are mitigated or subject to rate increases that reflects its loss history.

However, we would have concerns with applying these provisions to the older properties where there has been no flood or loss. These properties were charged a less-than-full premium rate because they were built before the flood risk was mapped or known. At the time these properties were built, there were not the NFIP standards to which they could build. Congress believed it was better to encourage these owners to participate in the NFIP under the lesser rate and mitigate or strengthen their properties against flood risk so that the taxpayers would not have to pay for the future damage through disaster assistance payments. Under the draft bill, the owners of these properties, who may have been contributing premium dollars to the NFIP for decades, would now have to pay significantly more, not because there has been a flood or loss or even a change in their flood risk. Instead, they are being asked to pay more because ownership of the property has changed (through sale of a primary residence) or the property is not the owner's primary residence (i.e., it's a non-primary residence or non-residential property).

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.

We have concerns about the affordability of these provisions and respectfully request that the Subcommittee reconsider applying them to older properties without a demonstrated loss. At a minimum, any provisions should:

1) Spread out any rate increases evenly over the entire base over time so that everyone has ample opportunity to adjust to the increases and no one has to shoulder the entire increase in a single year. For example, the discussion draft would gradually phase-in the rate over at least a five-year period that would not begin until one year after the date of enactment. 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.
2) Ensure that the primary residences receive the same phase-in flexibility as the other older properties. Currently, there appears to be a technical error in the draft bill. Under Sec. 5(c)(3), annual rate increases are tied to a fixed date – i.e., they would begin at "the expiration of the 12 month period that begins on the effective date of the Act" and increase by a maximum of 20% per year until the full-risk rate is achieved. However, if a primary residence is sold after the full rate has been achieved, the owner would not benefit from the phase-in; the rate would more than double overnight. Any such residence sold after the phase-in begins but before the full rate is achieved, would see a less gradual increase than those properties sold prior to the phase-in. NAR strongly urges the Subcommittee to correct this technical drafting error by tying the phase-in for primary residences to the point of sale, not the bill's effective date.
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 residential and commercial properties, including multifamily housing, non-primary residential and commercial properties.
5) 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. A similar study was included in the House passed bill.

Section 6: Technical Mapping Advisory Council.

This section establishes a Technical Mapping Advisory Council to propose new standards for more accurate flood maps. It would include a real estate expert on the Council.

NAR Comments: We support efforts to improve the accuracy of floodplain maps. We believe that to effectively meet its charge, the Council must include a real estate expert as a member.

Section 7: FEMA Incorporation of New Mapping Protocols.

These provisions require FEMA to:

- Implement the standards and update the maps within 5 years subject to appropriations.
- Report to Congress if it does not implement all the Council recommendations.
- Ensure that floodplain mapping delineates not only the 100-year floodplain but also:
    - The 250-year floodplain;
    - Areas of residual risk (behind levees, dams or other man-made structures); and
    - Areas "subject to graduated and other risk levels, to the max extent possible."

NAR Comments: Bill provisions to improve the accuracy of flood maps imply that at least some of the 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 250-year floodplain, residual- and other-risk areas.

Section 8: Privatization Initiatives.

This section would:

- Require FEMA and the GAO to report to Congress with recommendations on privatizing the NFIP.
- Authorize FEMA to carry out "Private Risk-Management Initiatives" to "determine the capacity of private insurers, reinsurers, and financial markets to assist communities, on a voluntary basis only, in managing the full range of financial risks associated with flooding."

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 Subcommittee to strike this section.

Section 9: FEMA Annual Report on Insurance Program.

NAR comments: None.

Section 10: Technical Corrections.

NAR comments: None.

Section 11: Community Building Code Administration Grants.

NAR Comments: Expanding grant authority to strengthen properties against flood loss is reasonable.

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 Subcommittee is considering a bill that makes difficult reform choices, it 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 Subcommittee 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