HEARING BEFORE

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

ENTITLED
"NATIONAL FLOOD INSURANCE REAUTHORIZATION"

TESTIMONY OF
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ON BEHALF OF
THE NATIONAL ASSOCIATION OF REALTORS®

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Introduction

Chairman Dodd, Senator Shelby and members of the committee, on behalf of more than 1.1 million REALTORS® who are engaged in all aspects of the residential and commercial real estate sectors, thank you for inviting me to testify today regarding reauthorization and reform of the National Flood Insurance Program (NFIP).

My name is Nick D'Ambrosia. A REALTOR® since 1973 and licensed in Maryland, Virginia and the District of Columbia, I am currently Vice President of Training and Recruiting for Long & Foster Companies. Long & Foster is the largest independently owned real estate company in the United States operating with 13,000 sales associates, 2,500 employees and 190 offices across seven states and Washington, D.C. I am also Vice Chair of the Maryland Real Estate Commission, where I have served as chair and industry member since 2005. For many years, I have been active within the National Association of REALTORS® (NAR), holding significant positions at the national and state levels, including President of the Maryland Association of REALTORS®, as well as the Prince George's County Association of REALTORS®. I also served as a member of NAR's Enlarged Leadership Team, Executive Committee, and Board of Directors, as well as numerous NAR standing committees, task forces and presidential advisory groups. Most recently, I was a member of NAR's Property Insurance Task Force that was charged with examining how access to affordable property insurance for the plethora of natural disasters, including flooding, might be achieved.

Since September of 2008, Congress has approved eight short-term extensions of authority for the NFIP. On two occasions, Congress has allowed authority for the program to expire for several weeks at a time. Each time NAR estimates that tens of thousands of real estate transactions were delayed if not cancelled. In addition, the many shutdowns and short-term extensions have exacerbated uncertainty in what are already troubled residential and commercial real estate markets. Earlier this year, the House of Representatives passed H.R. 5114, the Flood Insurance Reform

Priorities Act, to reauthorize the NFIP for a full five years. While this bill makes some difficult changes to the program, we would encourage the Senate to take up this legislation so that the program may be reauthorized long-term and continue writing flood insurance without further market disruption. We also note several efforts underway for a straight year-long NFIP extension, including one to September 30, 2011, in S. 3607 (Department of Homeland Security Appropriations, FY2011) which has been approved by the full Senate Committee. In any event, we would urge the Senate not to let the NFIP lapse again which would only further undermine the already fragile confidence in recovering real estate markets. At a minimum, the Senate should pass the year-long extension, as part of must-pass legislation or as a free standing bill.

The Importance of the NFIP

In 1968, the Congress established the NFIP because of the lack of available flood insurance in the private market and the rising cost of taxpayer-funded disaster relief to flood victims, which, up until that time, had been the only way to pay for rebuilding after a flood. Still today, virtually no market exists for flood insurance. According to the General Accountability Office (GAO), only four large companies provide "almost all the private flood insurance" and only then for owners with "high net worth" and properties valued at "at least $1 million.[1] Most American taxpaying families and small business owners would be priced out of what market exists for flood insurance were it not for the existence of the NFIP. Without this critical program, most Americans would not have access to a vital protection against loss of life and property due to the very real risk of flooding.

The most common natural disaster in the United States, each year floods are responsible for 140 deaths according to NOAA and on average $6 billion in losses by the U.S. Army Corps of Engineers' estimate. The GAO put it best:

[1] GAO, "Information on Proposed Changes to the NFIP," Report to Representative Barney Frank, Chairman of the House Committee on Financial Services, pp. 18-19.

> "…[B]ecause flooding is so widespread, it presents risks to a large segment of the population. For example, we found that between 1980 and 2005, approximately 97 percent of the U.S. population lived in a county that experienced at least one declared flood disaster; about 93 percent lived in counties that had experienced two or more flood disaster declarations; and 45 percent lived in counties that experienced six or more flood disaster declarations."[2]

Contrary to critic's assertions, the NFIP does not represent a cross subsidy from the interior of the U.S. to coastal states. While it is true that more than half the U.S. population lives within 50 miles of the coast and has access to the NFIP in participating communities (as does everyone else in a participating community), everyone benefits from a national flood insurance program. We have appended to this testimony a map developed by the GAO presenting the number of flood disaster declarations by county between 1980 and 2005. Areas of the country that have yet to experience flooding at a magnitude to warrant a disaster declaration are shown in white. As you will note, there is very little white space on the map. Maintaining access to affordable flood insurance is, therefore, of critical national interest to the whole of the United States, not just its coastal residents.

By providing flood insurance, the NFIP effectively reduces the amount of federal post-disaster assistance, paid by all taxpayers including those in the interior. For example, of the $88 billion obligated to Gulf Coast states after the 2005 hurricane season, $26 billion went directly to under-insured property owners according to the GAO.[3] That is $26 billion in taxpayer-financed rebuilding assistance which would not have been necessary had more properties been insured, because then, insurance -- and not taxpayer-paid assistance -- would have paid for rebuilding those

[2] GAO, "Natural Hazard Mitigation: Various Mitigation Efforts Exist, but Federal Efforts Do Not Provide a Comprehensive Strategic Framework," (August 2007), pp. 11-12.

[3] GAO, "Natural Disasters: Public Policy Options for Changing the Federal Role in Natural Catastrophe Insurance," (November 2007), Figure 3.

properties. Fortunately, there was an NFIP that was authorized at the time to insure approximately half the properties in the floodplains which were in the path of those 2005 mega-storms.[4] But for the NFIP, the taxpayer-assisted number ($26 billion) would have been significantly higher.

Also, the NFIP reduces flood damage by requiring communities to adopt and enforce strict floodplain management and mitigation regulations as a condition for their residents to be able to buy NFIP coverage. Nearly 20,000 communities have adopted these rules, averting $16 billion in losses since 2000 alone according to the U.S. Department of Homeland Security. Buildings constructed to NFIP standards experience 80% less damage than those not built to standards. As one program evaluation finds, the NFIP "has clearly induced savings on flood costs" and that "flood insurance has shifted the loss from taxpayers to those who pay the insurance premium."[5] In fact, the NFIP saves taxpayers money as well as property.

Some have asserted that the NFIP encourages development of "environmentally sensitive areas." Not so. Government-backed insurance is not the deciding factor to locate in the floodplain. According to NAR research, neighborhood quality or access to parks or beaches is far more likely to drive the decision. Historically, this country was built in floodplains along rivers and coastlines. Long before the NFIP was even contemplated, New York, New Orleans, Boston, Miami, St. Louis, Pittsburg, Cleveland, Houston, and Washington, DC, were already well established in what today FEMA designates as the floodplain. Since then, there have been program reforms which prevent development of the most sensitive coastal areas. Under the Coastal Barrier Resources Act of 1982, all of these areas are off limits to the NFIP, though interestingly, not to privately financed development or insurance. A report released in October 2006 that found "[t]he common belief that

[4] Pacific Institute for Research, "Costs and Consequences of Flooding and the Impact of the National Flood Insurance Program" (October 2006), p. 28 (hereafter, "PIR Study"), p. 36.

[5] PIR Study.

the NFIP has stimulated development that increased flood losses is not supported by our findings."[6] Whether national flood insurance is available or not, there will continue to be floodplain development; the difference is that the NFIP saves taxpayers money as well as property.

Others have claimed that the NFIP writes policies in wealthy resort communities, but for every policyholder in Hilton Head Island, SC, or Naples, FL, there is one in a home on the Red River in North Dakota or a rental property along the Missouri River in Iowa. The Congressional Budget Office (CBO) has found no evidence to suggest that the NFIP would cover larger or more luxurious structures, whether inland or in a coastal area.[7] Another study on the NFIP found that those in the middle-income brackets were less likely to live in floodplain areas than either of those in the highest or lowest income brackets. That study noted that "low income households [defined as $10,000 - $30,000 per year] live in hazardous areas in order to find affordable housing or because they work in water recreation areas and find the least expensive housing nearby."[8] If someone is able to afford a multi-million dollar beach-front property or resort development, they are going to look to insurance companies willing to write coverage above the $350,000 coverage limits imposed by the NFIP (i.e., $250,000/structure and $100,000 for contents). It is the lower and middle class families, retirees on fixed incomes and locally-owned small-business owners who have been priced out of the private market for flood insurance, for which this federal program is designed.

NAR Urges Long-term NFIP Reauthorization

Since September 2008, Congress has adopted eight short-term extensions of statutory authority for the NFIP – all within a few days of the deadline. (This includes the current extension to September 30, 2010.) Twice, authority has been allowed to expire. Each time, NAR estimates that

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6 Ibid, p. 41.

7 CBO, "Value of Properties in the National Flood Insurance Program," (June 2007), p. 7.

8 PIR Study, p. 43.

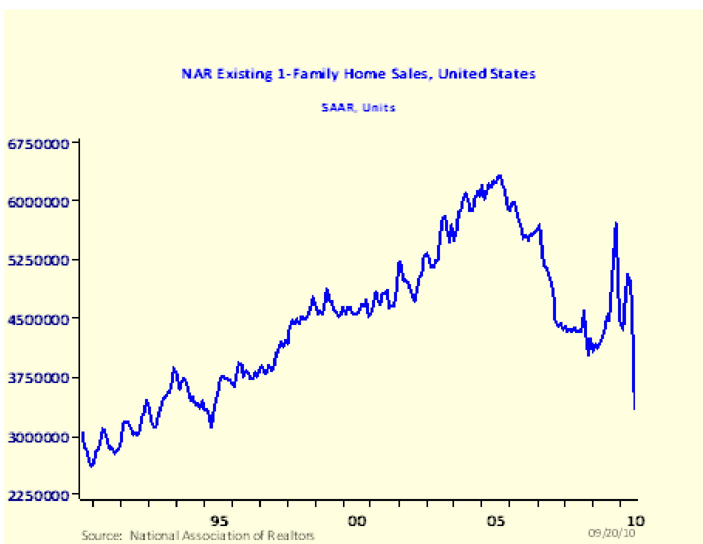
tens of thousands of real estate transactions were either delayed or cancelled. Without flood insurance, federally-backed mortgages may not be secured in residential or commercial real estate transactions in nearly 20,000 communities across the United States. Because the NFIP did not have authority to issue any policies, property owners lost confidence that they would be able to renew their existing policy when the time came. While we can quantify the cost of delaying real estate closings, the shock to consumer confidence due to the many stop-gap extensions is immeasurable. This month-to-month approach has hindered a recovering real estate market and only exacerbated the uncertainty for more than five and a half million taxpayers who depend on the NFIP as their main source of protection against floods.

On September 30, 2010, about a week from today, again NFIP authority is set to expire. This will be the ninth time in two years that the Congress will have to re-extend this important program. Recently, the House of Representatives passed H.R. 5114, the Flood Insurance Reform Priorities Act to reauthorize the NFIP for a full five years. While this bill makes some difficult changes to the program, we would encourage the Senate to take up this legislation so that the program may be reauthorized long-term and continue writing flood insurance without further market disruption. We also note several efforts underway for a straight year-long NFIP extension, including one to September 30, 2011, in S. 3607 (Department of Homeland Security Appropriations, FY2011) which has been approved by the full Senate Committee. In any event, we would urge the Senate not to let the NFIP lapse again which would only further undermine the already fragile confidence in recovering real estate markets. At a minimum, the Senate should pass the year-long extension, as part of must-pass legislation or as a free standing bill.

Reforms of the NFIP

For over four decades, the NFIP has been largely self-supporting, collecting sufficient premiums to cover claims and expenses. In the few years when this was not the case, the program was able to pay back the debt with interest according to the Congressional Research Service.[9] But then in 2005, Katrina, Wilma, and Rita struck and shattered all records including the highest number of Category 5 hurricanes in a season, and the NFIP now owes approximately $19 billion to the U.S. Treasury (including the nearly $3 billion for Ike and Midwest floods of 2008). 2005 was an anomaly. According to the Federal Emergency Management Agency (FEMA), which manages the NFIP, this debt is greater than the sum of all previous losses since NFIP's inception in 1968. Accordingly, NAR supports reforms to strengthen the program's long-term fiscal viability.

At the same time, the housing market continues to be weak as the country recovers from the longest recession since World War II. In the months immediately following the expiration of the homebuyer tax credit, home sales plunged to 15-year lows. Below is NAR's chart of existing home sales. In addition to overall economic weakness, including high unemployment, the housing market is plagued by excess inventory of distressed properties including foreclosures. While affordability remains strong and prices are beginning to show signs of stabilization, the housing market is in a precarious position and cannot afford any further negative shocks.



[9] Congressional Research Service, "National Flood Insurance Program: Background, Challenges, and Financial Status," (July 2009).

The commercial real estate market is also 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 $1.4 trillion in commercial real estate loans coming due over the next several years, 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, without access to affordable flood insurance. The lack of flood insurance for property owners, in many cases, would hold up the sale of commercial properties, further contributing to the economic crisis.

Against this backdrop, NAR would encourage Congress to strike a balance between the following NFIP reforms and real estate affordability, especially for lower-income homeowners and renters who often live in the nation's lower-lying communities

Coverage Limits. Additional coverage would attract new NFIP participants. 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, business interruption and the replacement cost of contents would help increase protection for home- and small-business owners. Increasing the maximum coverage limits for residential properties, non-residential properties, and contents coverage would more accurately reflect increases in property and contents values and provide fuller coverage to policyholders. These limits have not been adjusted despite inflation since 1994.

Education & Outreach. Educating consumers could also increase participation. Many consumers may not be aware that flood insurance is available to them or believe that a standard homeowner's policy would cover flood damage, which is not true. Only 50% of homeowners in the federally designated floodplain purchase flood insurance.[10] NAR would support provisions for outreach, education and information to consumers about the availability and importance of flood insurance.

Severe Repetitive Loss Properties. NAR strongly supports extending and fully funding the pilot program to mitigate properties which have repeatedly suffered insured flood losses. While less than 1% of NFIP-backed properties fall into this category, severe repetitive loss properties represent a disproportionate share of payouts from -- and pose a significant financial burden to -- the NFIP. Yet the owners, despite repeated losses, have declined a reasonable offer of mitigation funding from FEMA. Moreover, research conducted by the Multihazard Mitigation Council of the National Institute of Building Sciences has found that each dollar spent on mitigation saves society an average of four dollars.[11]

Pre-FIRM properties. While NAR strongly supports phasing-in higher rates, proportionate to risk, for properties with a repeated or demonstrated history of loss, there is not an equally compelling policy basis to phase-in the rate for all properties built prior to the existence of the flood rate maps (pre-FIRM). In the mid-1970s, Congress grandfathered these properties in under a rate less than the actuarial ("full risk") one, because they were built before the flood risk to the community was known and could not have retrofitted to NFIP standards immediately or cost

[10] PIR Study, p. 36.

[11] Multihazard Mitigation Council, "Natural Hazard Mitigation Saves: An Independent Study to Assess the Future Savings from Mitigation Activities, Volume 1 – Findings, Conclusions and Recommendations," National Institute of Building Sciences, Washington, D.C. (2005), p.5.

effectively. Changing the rules in the middle of the game for these property owners would have been perceived as unfair and even punitive.

Unlike the repeated/demonstrated-loss properties, many pre-FIRM properties have never filed a claim. Their flood risk has never changed. Yet these owners, who have been paying into the NFIP for years, could be expected to immediately pay significantly more under previous legislative proposals. FEMA estimates that if the average pre-FIRM policy were to pay the full actuarial premium, that premium would be increased to about two and a half times the current level; 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 severely impact on the cost of home ownership and rents especially in older communities as well as those that rely on tourism. This could lead to additional rounds of delinquencies, foreclosures and reduced property tax bases in these communities.

<u>Rate Structure</u>. Over the years, Congress has considered a range of proposals to strengthen the NFIP's long-term solvency, including increasing the statutory limit on the annual rate increase, setting minimum deductibles for claims and phasing in actuarial rates on the less than 20% that are pre-FIRM properties. While we continue to have significant concerns about the affordability of these reforms, we would urge the Committee to:

1) Continue to include comprehensive coverage for all residential and commercial properties, including multifamily housing, non-primary residential and commercial properties.
2) 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, H.R. 5114 (as passed by the House) would gradually phase-in

the rate over at least a five year period that would not begin until three years after the date of enactment, rather than immediately. 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.

3) Separate out multi-family rental properties of 4 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) Not adopt "back-door" or arbitrary rate increases for all NFIP properties, by requiring FEMA to recalculate "average loss year" to include catastrophic loss years "in accordance with actuarial principles." By law, rates are already set based on actuarial principles (see 42 USC 4015(b)(2)) so reiterating this does not justify the new provision. However, including outlier years in the calculation of average loss, as this amendment would, will arbitrarily inflate the amount a rate would have to cover and therefore the rate itself; and

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.

<u>Reserve Fund</u>. We support the concept of establishing a reserve fund to cover the higher than average loss years. However, a previous proposal 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, the Agency 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.

Flood Mapping. Another issue that has been the subject of discussion in recent years is requiring the purchase of flood insurance in the 500-year floodplain. Properties in the 500-year floodplain face a less-than-1-percent annual chance of flooding. This idea poses its own set of challenges and concerns from NAR's perspective, and many are similar to concerns faced by the NFIP in administering the current program. FEMA has been trying to update the 100-year flood maps, but the process itself of digitizing and modernizing is byzantine and slow. Other concerns include accurate mapping of the 500-year floodplain, an accurate assessment of the number of properties that will be impacted, notification of property owners that they now must purchase flood insurance, additional administrative burdens placed on FEMA to administer a much larger program, and keeping homes affordable while avoiding new and costly insurance requirements. Before imposing this requirement on property owners already hard hit by the recession, NAR would recommend a study to assess the costs and impacts of such a new requirement on homeowners and local economies.

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 House has passed a bill that makes some difficult reforms to the program, 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. We would encourage the Senate to take up this legislation so that the program may be reauthorized long-term and continue writing flood insurance without further market disruption. We also note several efforts underway for a straight year-long NFIP extension, including one to September 30, 2011, in S. 3607 (Department of Homeland Security Appropriations, FY2011) which has been approved by the full Senate Committee. In any event, we would urge the Senate not to let the NFIP lapse again which would only further undermine the already fragile confidence in recovering real estate markets. At a minimum, the Senate should pass the year-long extension, as part of must-pass legislation or as a free standing bill.

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 members of the Committee to develop meaningful reforms to the NFIP that will help protect property owners and renters and help them prepare for and recover from future losses resulting from floods.

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