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TESTIMONY OF

DAVID MCKEY

2016 INSURANCE COMMITTEE VICE CHAIR

NATIONAL ASSOCIATION OF REALTORS®

TO THE

UNITED STATES SENATE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

HEARING TITLED

"NO MORE HIKES: SMALL BUSINESS SURVIVAL AMIDST UNAFFORDABLE FLOOD INSURANCE RATE INCREASES"

JUNE 30, 2016

Introduction

Chairman Vitter and Ranking Member Shaheen, thank you for the opportunity to testify today. My name is David McKey. I am the Managing Broker/Owner of Coldwell Banker One in Baton Rouge, and I am here today representing the views of 1.1 million members of the National Association of REALTORS® where I am currently vice chair of the Association's 2016 Insurance Committee. I've also been active in association matters for many years at both the state and local levels -- most recently serving as the 2013 President of the Louisiana Association of REALTORS®. I am a small business owner myself, and bring to the table both the local and national perspective on flood insurance, which I can attest first hand, is a matter of vital importance across the United States.

Chairman Vitter, REALTORS® appreciate your continued leadership on flood insurance and especially your hard work last Congress. I would note that you were one of the original team of Senators and House members that drafted the "Homeowner Flood Insurance Affordability Act" which became Public Law #113-89. I am pleased to report the Affordability Act has succeeded in reigning in the most excessive and inaccurate flood insurance rate increases across the country. NAR looks forward to continuing to work with you and the Senate to build on these critical affordability reforms before current authority for the NFIP expires on September 30, 2017.

Importance of Small Businesses

Small businesses are the very engine of U.S. economic growth and make up more than 99 percent of employers, 63 percent of new jobs, 49 percent of employment, and 46 percent of output, according to the U.S. Small Business Administration (SBA).[1] Small businesses also provide the very competition that keeps prices down, and drives most of the job creation and innovations in the U.S. In Louisiana alone, small businesses created 25,000 jobs in the most recent SBA annual data and employed over half of the state's private workforce.[2]

At the same time, flood insurance became a greater expense for U.S. property owners; especially the small business owners with less over which to spread the cost relative to large competitors. Indeed, the Bureau of Labor Statistics recently reports that 27,000 Louisiana establishments and half million jobs are at risk of storm surge flooding.[3] For these reasons, it is especially important that any flood insurance rate increases continue to be spread out and gradually phased-in over time so small business owners will have adequate time in order to transition, plan and adapt accordingly.

Implementation of the Biggert-Waters Act

Before the Affordability Act, thousands of small business owners faced immediate and excessive rate increases under the Federal Emergency Management Agency's (FEMA) implementation of the "Biggert-Waters Flood Insurance Reform Act" (BW12). In Louisiana, while most policyholders (83

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[1] See: https://www.sba.gov/sites/default/files/FAQ_March_2014_0.pdf

[2] For SBA's state profile of Louisiana:: https://www.sba.gov/sites/default/files/advocacy/LA_0.pdf

[3] Please see BLS's estimates at http://www.bls.gov/cew/hurricane_zones/maps.htm#Louisiana

percent) were already paying full cost for flood insurance coverage, the 4 percent with older business properties were seeing rate increases in excess of 25 percent when those properties were purchased[4].

Under the House-passed version of BW12 (H.R. 1309), owners of older business properties – i.e., built before the first flood insurance rate map or pre-FIRM – were not supposed to pay more than a 20 percent annual increase – even at the time of property sale. In the Senate Banking Committee's reported bill (S. 1940), pre-FIRM businesses effectively paid a 25 percent increase. (Under both, all post-FIRM properties including businesses were capped at 20 or 15 percent, respectively.) It was clearly the expressed will of Congress to gradually phase-in the rate increases, particularly for small businesses.

Yet Section 205 that was enacted in BW12 as part of the 2012 Highway Bill included a second provision that prohibited owners of "any property purchased after the date of enactment" from paying less than the full cost for flood insurance. This created a conflict, since under one provision of BW12, older business property owners would pay 25 percent annual increases until they reached full cost, but under another, the buyer's premium would jump 100 percent to full cost upon property purchase. In its implementation guidance to insurers, FEMA offered no clarity on whether this purchase provision was to apply to business properties. To make matters worse, FEMA did not issue the guidance for more than a year while thousands of business properties were bought and sold. As a result, insurers filled the vacuum by raising rates 25 percent until the property sold, in which case rates increased to the full-cost rate for the new owner. For most of these small business owners, the insurance renewal notice was the first time they were informed of the BW12 increase.

Real Estate Market Impacts

News reports of surprise "$30,000 flood insurance" notices drove buyers away from properties located in the floodplain and had a chilling effect on real estate markets everywhere. In addition, implementation of BW12 Section 207, which would phase out "grandfathering," loomed. Most property sellers did not know if their property had been grandfathered under lower risk rate tables at some point in the past because the information was not tracked or included in standard insurance rate quotes until more recently. All that buyers knew was what they heard or read in the news and they worried that they too could one day find a $30,000 bill in the mail.

REALTORS® anecdotally reported that often their buyer's first words were directions not to show them any listings in the floodplain. Property owners began marketing their property as "does not require flood insurance." In many cases, owners were left with a property which could not be sold at a price required to cover the costs of selling. [5] Not only were the premium increases affecting sellers but also entire neighborhoods, local economies and community tax bases.

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[4] For NFIP's analysis of the impacts on the state of Louisiana: http://www.fema.gov/media-library-data/20130726-1912-25045-2652/bw12_impact_fs_04092013_louisiana_508.pdf

[5] According to a 2013 RAND study of New York City, a $500 insurance premium increase is associated with a $10,000 decrease in property value based on previous research: http://www.rand.org/pubs/research_reports/RR328.html

REALTORS® help others buy and sell their properties. What differentiates the REALTOR® from other real estate agents is their pledge to conduct themselves according to a strict code of ethics. Much of the business comes from word-of-mouth referrals so it is especially important to build and maintain working relationships with former clients. To succeed, clients must be kept informed. Big surprises at the closing table are never good.

BW12 made an already difficult job more complicated. When a property owner received the flood insurance renewal notice for a substantial increase, often the first call they made was to their real estate professional, demanding to know why this information was not disclosed sooner. Like the buyer, real estate professionals rely on insurance professionals to quote accurate flood insurance rates. The truth is the real estate professional could not have known what the insurance agent did not include in the original rate quote.

Many real estate professionals have reported that they tried to help past clients by contacting FEMA directly, but typically, no one there seemed able or willing to verify the accuracy of the rate increases. Eventually, many turned to independent flood insurance experts to identify and document mistakes in the rate quotes in an effort to bring down premiums. Often, the experts was able to find at least one mistake, but the insurance company frequently refused to make any rate change until FEMA directly weighed in. In one case documented in earlier NAR Congressional testimony, one expert succeeded in reducing the NFIP rate from over $10,000 down to just $500 per year, because five separate insurance agents input incorrect property information in their insurance rating software.[6]

Flood Insurance Affordability Amendments

The Affordability Act addressed the most immediate and pressing issues facing business property owners by 1) re-setting NFIP rates back to pre-BW12 levels; 2) capping all future increases going forward; and 3) refunding the difference between what most policyholders actually paid versus what they should have – reestablishing the original congressional intent for 25 percent increases. The Act also established the Office of the Flood Insurance Advocate (OFIA) to assist with flood mapping and insurance rating concerns because policyholders should not have to hire outside contractors to oversee insurance companies when FEMA should be monitoring and enforcing its own rules.

Since passage of the Affordability Act, the average NFIP rate increase has been about 10 percent per year, which is consistent with the increases prior to BW12. In addition, policyholders have begun paying a new surcharge of $25 or $250 depending on the building in order to cover the cost of the Affordability Act's rate corrections. FEMA also stood up the OFIA and named David Stearrett as director. I am pleased to report that under Director Stearrett's leadership, the Office has already assisted hundreds of property owners with their flood insurance concerns. NAR looks forward to working with OFIA, FEMA and Congress to build on these early successes and strengthen an office whose principal focus is to advocate for fairness on behalf of policyholders.

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[6] For more information about this, see example #3 in the appendix of NAR's November-2013 testimony before a House Financial Services Subcommittee: http://www.ksefocus.com/billdatabase/clientfiles/172/1/1914.pdf

Remaining Issues

While the Affordability Act addressed the most inaccurate rate increases, there are still some remaining issues which NAR would like to bring to your attention:

- **NFIP Rate Escalator**. The Affordability Act did clarify that the owners of business properties built before the first flood insurance rate map (or pre-FIRM) will pay no more than a 25 percent increase each year. However, the 25 percent increases do not stop until the small business owner proves that they are being charged the full-cost premium for the property. This requires the owner to hire a licensed surveyor and provide FEMA with an elevation certificate; elevation certificates can cost anywhere from a few hundred to thousands of dollars. If the certificate shows that the property owner has already reached full cost, the owner may request an optional full-risk rating and end the 25 percent increases; otherwise, the owner stays on the escalator.[7] Yet, many property owners tell our members that they have not been informed of this option. Others fear that they could see more than a 25 percent increase if the certificate shows they're paying too little and so choose not to pursue the optional rating. Still others may lack the financial resources needed to spend out of pocket and obtain an elevation certificate. As a result, today, many small business owners are stuck on an endless escalator of 25 percent increases even when they may already be paying more than full cost for flood insurance.

- **Unknown Scope of Affordability Issues –** Where will the rate escalator end and how many are facing unaffordable premiums in 5-10 years? FEMA cannot definitively answer this question because it does not have elevation data on the one million pre-FIRM properties in the program. The Agency believes that most of these structures are located below the Base Flood Elevation – i.e., the expected depth of the flood waters during a 100-year storm.[8] Because the 25-percent increases are compounding annually under the statute, NFIP rates will grow exponentially. If FEMA takes a typical pre-FIRM property and projects 25 percent increases compounded into the future, it would only take a few years before NFIP rates return to levels that led to the public outcry after BW12. Based on the most recent FEMA rate tables, the maximum possible rate in the NFIP is $62,500 per year,[9] but without property elevation data, we won't know how many small businesses will actually reach rates on this order of magnitude.

  Under these circumstances, small business owners unable to afford the premium would have limited options. If they try to sell, the owners could be facing substantial losses. Yet at this level of flood risk, they are unlikely to find more affordable insurance coverage in the private market. Nor would they have access to the private financing that could help them to mitigate and bring

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[7] See page 25 at http://www.fema.gov/media-library-data/1458759698151-cf560057de33c2ad6df0b6c4e3ec4e82/05_rating_508_apr2016.pdf

[8] National Research Council. "Tying Flood Insurance to Flood Risk for Low-Lying Structures in the Floodplains," August 2015, page 1.

[9] The top rate in NFIP tables appears to be $25 per $100 of coverage; $250,000 is the maximum amount of structure-only coverage available under NFIP: $250,000 x $25/$100 = $62,500 per year. For NFIP's Specific Rating Guidelines: http://www.fema.gov/media-library-data/1450374017262-8d8a14ee8c48efb5356e9fb5b24ff2a1/SRG_April2016.pdf

down NFIP rates. FEMA's assistance programs can take years before owners might see a small grant if they're fortunate enough to live in a state and a community that will agree to apply on their behalf. The longer this situation is unaddressed, the more expensive the problem becomes. Without the data to determine the actual number of property owners facing unaffordable rates in the future, it is not possible at this time to determine the magnitude of the problem or the scope of programs/funding needed to solve it. Based on current estimates, about one million properties have subsidized insurance rates. If, for instance, the data showed that just 1,000 of these couldn't afford the future premium, FEMA could probably address the problem today using existing resources. But, if there are closer to one million properties in need, that would require congressional action and outside the box thinking. It is also unclear what the definition of affordability is for purposes of program design. If the goal were, for example, to not disrupt business operations no matter the flood risk, the program design would necessarily differ from one that aims to compensate companies for losses in equity. NAR believes that the LiDAR data, which is at the core of North Carolina's superior mapping program, would provide FEMA with the data it needs in order to assess the future affordability of NFIP rates.

NAR recommends adding a section to the 2017 NFIP reauthorization bill that would streamline and target mitigation options to pre-FIRM property owners facing unaffordable flood insurance. In the interim, FEMA requires some direction and resources in order to collect the LiDAR data needed to inform development of the bill's mitigation section. Providing property owners at risk with the ability to help themselves is a win-win not only for the owners who becomes able to mitigate and keep rates affordable but also for taxpayers, who would spend less on future claims for mitigated properties.

- **Cross Subsidization in the NFIP –** NAR commissioned a study of NFIP insurance rates that was conducted by the Milliman Company in 2015.[10] The study looked at NFIP rates in five counties with relatively high flood risk from different regions of the country – Pinellas, FL; Harris, TX; Ocean, NJ; Merced, CA; and Hancock, OH -- and compared them with the way a private insurance company would price the risk. The study shows many property owners are overcharged potentially by thousands of dollars under NFIP. Essentially, the federal program has only one rate table to charge risk-based premiums rates across the U.S. It is based on the national average flood risk to a typical property in a flood zone. As a result, two property owners facing different risks could pay the same rate. While there are additional rate tables for pre-FIRM properties as well as low risk properties, those tables don't even include elevation as a risk factor; thus, some low risk properties actually pay more than high risk properties. Moving toward more granular data and property specific hazard assessments, along with creating additional rate tables, would help to increase fairness in NFIP's rating structure. This in turn would encourage greater voluntary participation and help improve the program's solvency.

[10] For the full Milliman Report: http://narfocus.com/billdatabase/clientfiles/172/22/2540.pdf

- **"Guilty until Proven Innocent."** FEMA attempts to develop reasonably accurate flood maps based on available information, time and resources. The Agency relies on local communities to participate in the map development process, spot inaccuracies and pay for the data and analysis necessary to support corrections. Most local communities don't have the expertise or budget to appeal once a draft map is proposed and so it is often up to the property owner to take action. NAR members do not believe it is fair for the federal government to place the time and financial burdens of proof on property owners to ensure accurate flood maps. NAR notes that the state of North Carolina has taken over the flood mapping duties in the state from FEMA and moved away from elevation certificates. Instead, its mapping program is based on newer technologies such as Light Detection and Ranging or LiDAR (like radar but with laser pulses from aircraft). North Carolina is widely recognized to produce superior maps at a fraction of the cost when compared with FEMA's. NAR would like to work with Congress to replicate the NC-FEMA mapping partnership and improve the accuracy of the maps so fewer property owners will have to file expensive appeals.

NAR Recommendations

1) **Long-term Reauthorization.** The National Flood Insurance Program will sunset on October 1, 2017 unless Congress renews the program's authority to provide flood insurance. NAR urges Congress to reauthorize the program on time and for a minimum period of 5 years. Shorter term extensions only exacerbate market uncertainty and disrupt property sales where flood insurance is required for a federally related mortgage.

2) **Prospective Property Mitigation.** One million NFIP-insured properties are not yet paying full-cost rates. The more of these properties that are flood proofed, elevated, relocated or otherwise strengthened against the flood risk, the lower the NFIP rates will be and the less that taxpayers will be exposed to future NFIP borrowing. Fortunately, Congress already provides significant funding toward property mitigation programs. However, most of this funding is not accessible until *after* flooding occurs, i.e. when the cost of rebuilding increases, the dollars won't go as far, and the focus is on getting disaster victims back into their homes as quickly as possible. NAR encourages Congress to look government wide at all mitigation programs (including Community Block Grants, SBA Loans, etc.) to find ways to pool resources, target pre-FIRM properties and head off unaffordable NFIP premiums while there is still time and lower cost options available.

3) **Encouraging Private Market Options.** REALTORS® believe that private flood insurance can complement a strong and vibrant NFIP. Because NFIP is overcharging many property owners (e.g., due to the 25 percent escalator and cross subsidization), more opportunities exist for the private market to offer comparable coverage at lower cost. NAR supports the development of lower cost private market options. It is important, too, that consumers are allowed to move to and from the private market without the NFIP considering it a break in continuous coverage. Under the current system, such a break would trigger a rate increase should the owner return to

the NFIP. The combination of private market options and a strong NFIP will ensure that flood insurance remains available in all markets at all times.

NAR urges the Senate to take up and pass H.R. 2901, the Flood Insurance Market Parity and Modernization Act at the first opportunity. The bill would clarify that the federal mandatory purchase requirement may be satisfied with private flood insurance that covers at least the amount of the mortgage loan and complies with state law. It has been developing over multiple congresses, been the subject of extensive hearings and amendments and earlier this year, passed the House of Representatives by an overwhelming, bipartisan vote of 419-0. The clock is ticking on the remainder of the 114th Congress, and this modest reform measure could offer immediate rate relief for some property owners while making a down payment on broader NFIP reforms.

4) **Improving Flood Mapping using LiDAR.** To accurately determine whether properties are located in special flood hazard areas where flood insurance is required for a federally-related mortgage, FEMA must survey the first floor of structures relative to the Base Flood Elevation. Today, the burden is on the property owner to buy the first floor survey which costs anywhere from a few hundred to thousands of dollars and prove the structure is out, or else buy flood insurance. The state of North Carolina, on the other hand, has taken over FEMA's flood maps for the state and moved away from survey-based mapping. Instead, North Carolina uses LIDAR (like radar but with laser pulses from airplanes) to pinpoint the first floor elevations statewide at a fraction of the cost of alternative methods (approx. $15-$25 per property). FEMA may spend part of its mapping budget on LiDAR but the budget is severely limited.

Based on the information NAR has gathered so far, using LiDAR to map the nation would take a modest investment by Congress (less than $750 million) to produce benefits that are 4-5 times the cost. [11,12] If cost becomes an issue, one approach that Congress could consider would be to target a handful of states with the most subsidized NFIP policies and expand the effort as funds are available. NAR would like to work with the Committee and Congress to better estimate the costs of a North Carolina style program for mapping the entire country. Based on our current research, it appears that money currently within the system could be put to better use by focusing on advanced technologies. NAR believes that with LiDAR data, FEMA could produce more accurate maps, minimize the number of property owners filing expensive appeals, and determine the scope of the pre-FIRM affordability issues in order to "right size" its mitigation framework.

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[11] According to MAPPS, the national association of private sector geospatial firms, based on the following assumptions:

- A 2012 Dewberry study showed 14.5 million structures within the 100-year floodplain.
- A 2009 AECOM study showed an additional 6.8 million structures in the 500-year floodplain for a total of 21.3 million structures.
- A cost of approximately $25 per structure for building footprints and first floor elevations; and
- A contingency factor for unknowns and management.

[12] For a cost benefit analysis of national LiDAR options: http://www.dewberry.com/services/geospatial/national-enhanced-elevation-assessment

Conclusion

Thank you for the opportunity to testify about flood insurance. NAR greatly appreciates the Committee's work in this area. REALTORS® look forward to working with you and the Senate on these and other issues before the current authority for the NFIP expires on September 30, 2017.