

NAR Issue Brief

HR 2874 The 21st Century Flood Reform Act

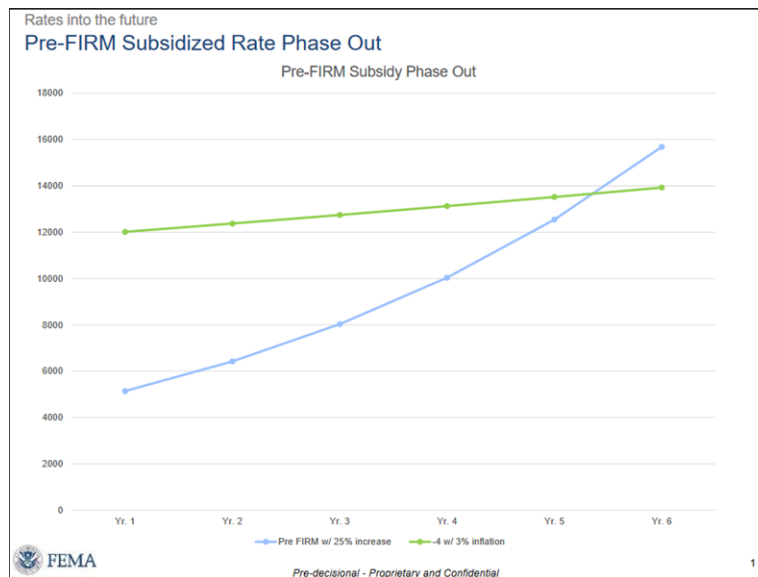
Opponents of **HR 2874: The 21st Century Flood Reform Act** are asserting that National Flood Insurance Program (NFIP) premiums will only increase under the legislation. Unfortunately, these claims are not supported by data or a plain reading of the bill. There appear to be some misunderstandings about the NFIP and many conflicts with expert testimony by the Congressional Budget Office (CBO), General Accountability Office (GAO) and others. It is important to separate myth from fact. Below are some common criticisms of HR 2874, and NAR's response. NAR urges the House of Representatives to bring up and pass the 21st Century Flood Reform Bill.

Claim: "HR 2874 will burden the policyholder that is trying to maintain a mortgage with much higher flood insurance premiums in the form of higher rate, surcharges and assessment."

Fact: Under current law, subsidized flood insurance premiums are climbing up to 25 percent each year until reaching full risk actuarial levels.¹

- However, under current NFIP regulations, the increases do not end until the policyholder provides an elevation certificate,² which costs from \$500-\$2,000 by FEMA estimates.³
- Many have already exceeded full risk but have not provided an elevation certificate.⁴
- FEMA recently refunded \$27,000 to one second homeowner who continued to be charged 25-percent for 3 years after providing an elevation certificate.⁵
- In figure 1, FEMA projects that the 25-percent increases for a typical policyholder would exceed \$10,000 in only three years and full risk rates in five years, unless Congress acts.⁶

Figure 1. FEMA's Projection of Subsidized NFIP Premiums under Current Law



¹ 42 USC 4015(e)

² Page RATE 25 in the latest Flood Insurance Manual at https://www.fema.gov/media-library-data/1503239106510-30b355cc754f462fe2c15d857519a71ec/05_rating_508_oct2017.pdf

³ Page 18 of <https://www.gao.gov/assets/690/684354.pdf>

⁴ For instance, RAND recently found that 76 percent of subsidized policyholders in New York City could pay less if they provided an elevation certificate. Page 40 at https://www.rand.org/pubs/research_reports/RR1776.html

⁵ Office of Flood Insurance Advocate (2017). See the spotlight on customer casework: <https://www.fema.gov/media-library-data/1492111537461-69e9c59a74626dab2efbd702696c50a8/OFIABimonthlyReportDEC2016andJAN2017.pdf>

⁶ Presentation to ASFPM (2016), page 1: http://www.floods.org/Files/Conf2016_ppts/E3_NealCecilStearrett.pdf

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Fact: The 21st Century Flood Reform Act would cap the flood insurance increases and in many cases, reduce the rates, surcharges and assessment.

- Section 101 reduces the maximum premium increase, including the reserve fund assessment,⁷ from 18 to 15 percent per year for most NFIP policies.
- HR 2868 creates a new cap on overall premiums of no more than \$10,000 per homeowner.⁸
- Section 102 authorizes state affordability programs to reduce rates for lower-income households.
- Section 104 directs FEMA to reduce rates for inland properties in coastal and riverine communities.
- HR 2565 reduces rates for lower value properties by using actual replacement cost values rather than a national average estimate to calculate rates.
- Section 201-204 and HR 1422 enable policyholders to shop for lower cost flood insurance from the private market without losing NFIP grandfathered rates.
- Section 502 cuts in half the current surcharge for lower risk second homeowners while adding only \$2 per month for others.
- Section 507 reduces the portion of the premium paid to the Write-Your-Own companies.

Claim: “First and foremost, Section 104 - Consideration of Coastal and Inland Locations in Premium Rates states that within two years premium rates will be revised to reflect the differences in flood risk of coastal flood hazards versus riverine or inland flood hazards.... There are very strong concerns that by adding another layer of differentiating risk (of which is unnecessary) **flood insurance rates are only going to go up.**”

Fact: Not according to actuarial analysis of the provision.

- Because the program currently uses three rate-setting factors that do not align with risk,⁹ many policyholders are overpaying for flood insurance while some are underpay.
- Section 104 directs FEMA to use at least one more factor– i.e., the property’s distance to coast.
- At the request of NAR’s insurance committee, independent actuaries with Milliman analyzed NFIP premiums considering the location of 243,000 properties in Pinellas County, FL.
- Milliman found that the average premium decreased from \$4,000 to \$1,900 per year when adjusting for the property’s location.

⁷ “When premium rate increases are evaluated for compliance with these caps, the building and contents premium, the Increased Cost of Compliance (ICC) premium, and the Reserve Fund Assessment (RFA) are all included.” FEMA, Page 1 of Attachment A found here: <https://nfip-iservice.com/Stakeholder/pdf/bulletin/w-16071.html>

⁸ Six other bills -- HR1422, HR2875, HR1558, HR2565, HR 2246, and HR2868 – are expected to be rolled into the 21st Century Flood Reform Act prior to House floor consideration.

⁹ Currently, NFIP uses three broad factors to rate high-risk structures: occupancy (e.g., single family, 1-4, etc.), type (one floor or more, basement or not), and relative elevation. <https://www.fema.gov/media-library-data/a10327c71a76f7c88d7cf403dcf60f4f/Actuarial-Methods-and-Assumptions-2013-09-04-508.pdf>

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- In fact, the location-adjusted premium (column D below) was always less than the average premium currently charged by the NFIP in high-risk zones (column C).
- Table 1 presents the results for the AE zone in Pinellas; read the full study results [here](#).

Table 1. Current NFIP Full Risk Premium vs. Section 104 in Flood Zone AE

	(A)	(B)	(C)	(D)
Miles to Coast	No. of Properties	Average Damage	Current Premium	Section 104
<0.025	12,237	\$ 5,168	\$ 17,185	\$ 9,397
0.025 - 0.05	3,914	\$ 4,681	\$ 14,748	\$ 8,511
0.05 - 0.075	3,919	\$ 4,459	\$ 13,636	\$ 8,107
0.075 - 0.1	2,812	\$ 4,129	\$ 12,529	\$ 7,508
0.1 - 0.015	4,302	\$ 3,767	\$ 11,401	\$ 6,850
0.15 - 0.25	4,338	\$ 3,609	\$ 10,466	\$ 6,563
0.25 - 0.5	5,612	\$ 3,426	\$ 9,375	\$ 6,229
0.5 - 1	6,704	\$ 3,645	\$ 9,436	\$ 6,627
1 - 3	11,679	\$ 2,237	\$ 7,797	\$ 4,068
3 - 5	1,958	\$ 1,554	\$ 5,333	\$ 2,808
>= 5	34	\$ 408	\$ 6,343	\$ 743
Total	57,509	\$ 3,745	\$ 11,628	\$ 6,808

Claim: “Why is [section 104] necessary considering that risk premium rates are already based on location? This is done through modeling used to determine the base flood elevation (BFE) of the 1% annual chance flood event in the development of flood maps...”

Fact: NFIP rates are based on flood zone, not location.^{10,11,12}

Fact: The same two flood zones (A-high risk¹³ and X-low risk) can be found in every state in the U.S.

¹⁰ According to the GAO:

“FEMA classifies properties according to flood risk using a single, nationwide class-rating system rather than an individual property or community-by-community rating system... Further, **FEMA charges the same rate** for a given class in the high-risk zone ... **regardless of location within the zone.**” See Page 23 at <http://www.gao.gov/assets/290/283035.pdf>

¹¹ The National Academies noted:

“... that the classification by flood zone is not spatially or geographically oriented. Rather, it focuses on common hazard properties. **Different locations in the United States will fall within the same zone** if they have the same difference between the 1 percent and 10 percent annual chance [floods] without regard to the underlying causes of the hazard. Pages 27-28 of <https://www.nap.edu/read/21720/chapter/5>

¹² CBO added:

“**Basing flood insurance rates on each structure’s local topography is not currently feasible**, however, because of the information requirements and administrative complexity involved. Instead, FEMA uses estimates of average topographic conditions to set uniform nationwide rates for Zone AE and for Zone VE.” Page 31 at <https://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/106xx/doc10620/11-04-floodinsurance.pdf>

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- As a result, two properties with different flood risk – e.g., one in a mountain valley and the other on a flat beach -- can be charged the same rate.¹⁴
- It also means that “some Zone-A policyholders face the risk of wave damage, but they pay the same rates as other policyholders in Zone A who face no such risk.”¹⁵
- For example, flood damage in Pinellas (column B above) is expected to range from roughly \$500 per year (5 miles from the coast) to \$5,000 (within 0.025 miles or 130 feet).
- Yet, the current premium is **nine** times more (\$6,300/\$700) for the \$500 risk but only **two** times more (\$17,200/\$9,400) for the \$5,000 risk.
- Section 104 would resolve the situation by requiring FEMA to account for property location.

Fact: While flood maps provide a base flood elevation, NFIP uses a different model to develop the rate tables.¹⁶

- The base flood elevation is only a reference point for NFIP rates.
- To develop the rate tables, NFIP calculates the expected average annual flood damage over all flood depths in a structure, and then loads and converts to a rate per \$100 of insurance.¹⁷

Fact: The mapped base flood elevation has a 1-percent annual exceedance probability, but NFIP rate tables vary from the 10 percent to 0.2 percent probability event.¹⁸

- In the 1970s, NFIP reduced a sample of flood insurance studies to 30 equations, called “probability of elevation” (PELV) curves.¹⁹
- Each PELV curve represents a nationwide set of floodplains that expect the same number of feet of water between the common (1-in-10 chance) and rare (1-in-100) floods.²⁰
- This assumes that two floodplains with a 3-foot difference have the same risk even if the two are 3,000 miles apart or one faces 3 feet of storm surge and the other, 3 feet of river rise.²¹

¹³ V-zones are simply a subset of the A-zone, where there is a 1 percent or greater chance of flooding in any given year, but the associated wave heights are 3 feet or more: <http://www.region2coastal.com/resources/coastal-mapping-basics/>

¹⁴ Page 23 of <http://www.gao.gov/assets/290/283035.pdf>

¹⁵ Page 17 of <https://cbo.gov/system/files/115th-congress-2017-2018/reports/53028-nfipreport2.pdf>

¹⁶ Here is the basic NFIP rate formula [Note: BFE is not a factor]:

$$\text{RATE} = [\text{Sum (PELV} \times \text{DELV)}] \times (\text{LADJ} \times \text{DED} \times \text{UINS}) / \text{EXLOSS}^{16}$$

Where:

PELV is the probability of floodwater reaching each depth in a structure

DELV is the ratio of flood damage to the value of insurable property for each depth

LADJ, DED, UINS are loss adjustment expenses, deductible and underinsurance

EXLOSS is a loading factor for expenses and contingency

See Page 4 of FEMA’s technical documentation in support of its 2013 risk rates: <https://www.fema.gov/media-library-data/a10327c71a76f7c88d7cf403dcf60f4f/Actuarial-Methods-and-Assumptions-2013-09-04-508.pdf>

¹⁷ Ibid. The basic rate setting steps are described on pages 4-7. CBO provides a less technical description in appendix A here: <https://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/106xx/doc10620/11-04-floodinsurance.pdf>

¹⁸ Page 15 of <https://www.fema.gov/media-library-data/a10327c71a76f7c88d7cf403dcf60f4f/Actuarial-Methods-and-Assumptions-2013-09-04-508.pdf>

¹⁹ Ibid

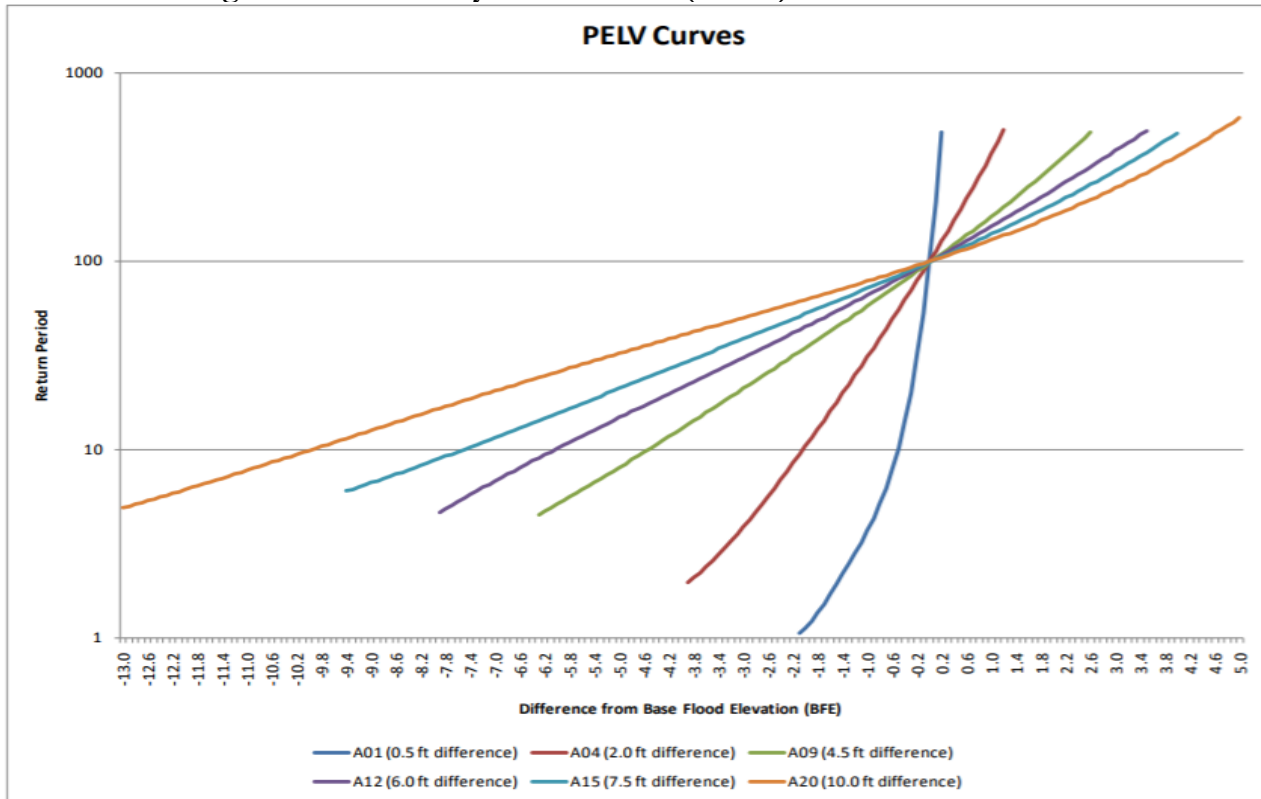
²⁰ Page 27 of <https://www.nap.edu/read/21720/chapter/5#27>

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- FEMA uses these PELV curves to weight the “damage by elevation” (DELV) curves, and then averages across all six curves to develop the NFIP rate tables.^{22 23}
- The 1-percent chance flood is only one point (0, 100) on the curve, where all six cross.²⁴
- Figure 2 (below) shows the six PELV curves used to develop NFIP rate tables.²⁵

Figure 2. “Probability of Elevation” (PELV) Curves used in NFIP rates.



Claim: “...There is a coastal model and a riverine model. Coastal models use past storm events, topography and other data to determine storm surge and BFE....”

Fact: According to CBO, “[NFIP rate setting] does **not** account for differences in exposure to wave damage for properties that are outside Zone V.”²⁶

- NFIP rates equal probability multiplied by average property damage over a range of floods.²⁷

²¹ See Page 6 of FEMA’s technical documentation in support 2013 risk rates: <https://www.fema.gov/media-library-data/a10327c71a76f7c88d7cf403dcf60f4f/Actuarial-Methods-and-Assumptions-2013-09-04-508.pdf>

²² Page of 31 <https://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/106xx/doc10620/11-04-floodinsurance.pdf>

²³ For the latest example of the AE zone risk rate table, see page RATE 7 at: https://www.fema.gov/media-library-data/1491846079273-28adf8361db1633c5445e716c15b0f58/05_rating_508_apr2017_v2.pdf

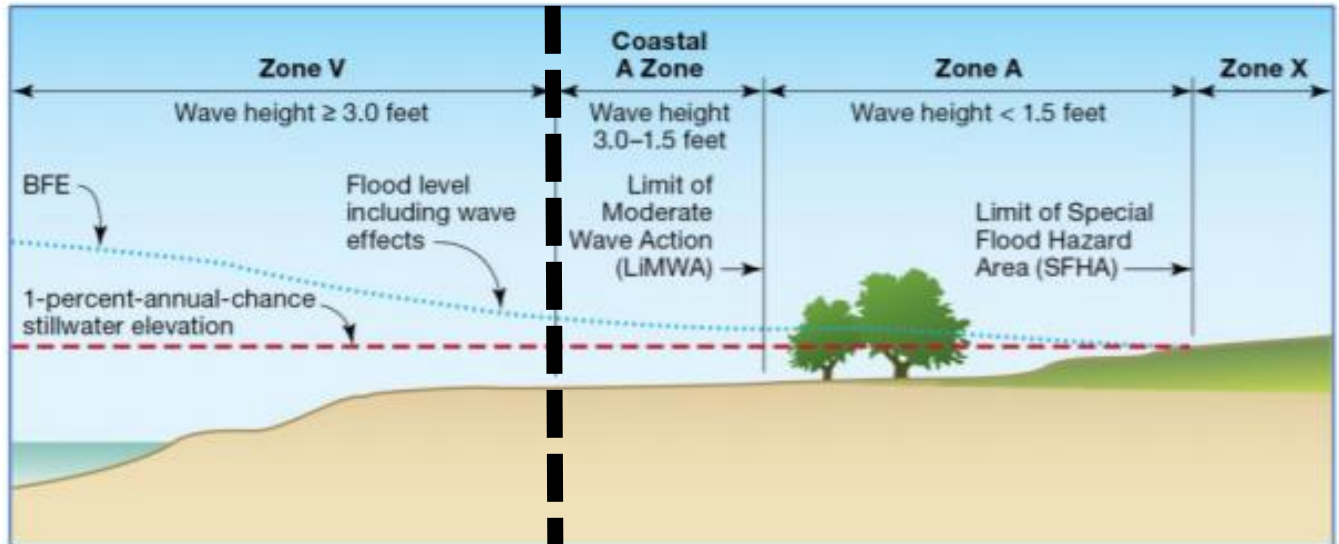
²⁴ Ibid

²⁵ Page 19 of <http://www.actuary.org/files/Eighteen-Months-After-Biggert-Waters-Is-the-NFIP-Staying-Afloat.pdf>

²⁶ CBO, pages 16-17: <https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53028-nfipreport.pdf>

²⁷ See footnote 17 above.

Figure 3. Schematic of V zones, A zones, and Coastal A zones.



Claim: “For those that do not understand the rating and mapping process, it may appear to be unfair that a property owner in say, West Virginia with the same zone and BFE of an Outer Banks property owner would pay the same rate, but again I stress the risk is the risk! One foot below base flood could in turn be one foot of flood water regardless of where it occurs.”

Fact: The risk of a foot of water is **not** the same in mountainous W.V. as the relatively flat Outer Banks:

- According to the CBO, “**structures at the same elevation relative to BFE—and hence exposed to roughly the same depth of water** (if any) in a 100-year flood—**may face different risks** from floods of other sizes. For instance, a house that is one foot above BFE may be safe from all floods smaller than a 300-year event if it is located in a broad, shallow floodplain.... Conversely, a house located one foot above BFE in a narrow, steep valley ... may suffer damage in all floods larger than a 130-year event.”³⁷
- GAO: “Two properties ... (for example, both are one-story, single-family homes with no basement and are elevated a certain number of feet above a reference level) are **charged the same rate** per \$100 of insurance **although they may be located in different states with differing flood experiences or rest on different topography such as a shallow floodplain versus a steep, mountainous valley.**”³⁸
- The American Academy of Actuaries: “For example, an AE-zone **building located in a West Virginia river valley** at a specific elevation would be **charged the same premium as a similar AE-zone building** with the same coverage details and elevation rating that was located **in a flat South Carolina floodplain—regardless of whether the two**

³⁷ Page 31 of <https://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/106xx/doc10620/11-04-floodinsurance.pdf>

³⁸ Page 10 of <http://www.gao.gov/assets/290/283035.pdf>

buildings had significantly different flood-loss histories and assuming both had the same community rating system status.”³⁹

Claim: “Considering this information, there is a need to clarify Section 101 – Annual Limitation on Premium Increases. While this provision looks like a level of protection for the policyholder that would prohibit premiums from increasing more than a certain percentage each year, this will not likely happen due to rating changes that are implemented. **Any time new rates are implemented, the limitation does not apply.** This was widely noted after the passage of Biggert-Waters (B-W 12) in 2012 when new rates were developed based on actuarial risk that included catastrophic losses. Post BW-12, rates skyrocketed and some policyholders were faced with flood insurance premiums so high they were no longer able to pay their mortgage thus facing foreclosure. Properties for sale in special flood hazard areas saw a drop in the market value to the point of only attracting cash-only buyers to avoid the flood insurance requirement.”

Fact: Section 101 limitations apply to virtually all NFIP policies.

- As amended, 42 USC 4015(e)(1) reads: “the chargeable risk premium rate for flood insurance under this chapter **for any property** may not be increased by more than 15 percent each year, except—”
- The only exceptions are:
 - Policies subject to 25-percent annual increases (severe repetitive loss, substantial damage, etc.);
 - New or lapsed policies, which are subject to a prohibition against extending subsidies;⁴⁰
 - Policies that increase coverage, are misrated or downgraded in the community rating system.

Fact: The issues with the limitations under the Biggert-Waters Act have already been resolved.

- In 2012, the Biggert-Waters originally:
 - Expanded the new/lapsed policy prohibition against extending subsidies⁴¹ to include: (1) any property not insured or (2) not purchased by the date of enactment.
 - Eliminated the grandfathering of remapped properties that are built to code.
 - Did not set a limitation on how high NFIP rates could increase for an individual property owner; and
 - Doubled the limit on the average premium (from 10 to 20 percent/year) so individual property owners could see increases as high as a 40-percent.
- The Homeowner Flood Insurance Affordability Act of 2014 (P.L. 113-89) addressed these concerns:
 - Section 3 struck paragraphs 1 and 2 from the new/lapsed policy prohibition, enabling newly insured and property buyers to once again, assume existing NFIP policies.
 - Section 3 also rolled back the premiums to 2013 levels and refunded the difference.

³⁹ Page 11 at http://www.actuary.org/files/publications/AcademyFloodInsurance_Monograph_110715.pdf

⁴⁰ See 42 USC 4014(g)

⁴¹ Ibid.

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- Section 4 deleted the grandfathering provision, restoring the practice.
- Section 5 reduced the average premium from 20 to 15 percent per year and established a new limitation of no more than 18 percent per individual policyholder.
- Section 101 would maintain the average-rate limitation but reduce the per-property limitation from 18 to 15 percent, which is significant according to CBO.⁴²
- The only remaining issue under Biggert-Waters is that currently, rates can keep increasing 25 percent each year, beyond the full risk and potentially into the tens of thousands of dollars.
- The 21st Century Flood Reform Act would fix this by establishing a third limitation of no more than \$10,000 per year for residential properties, whether owner-occupied or not.

Claim: “While Sec. 507 – Pay for Performance and Streamlining Costs and Reimbursement is a step in the right direction, the allowance paid to the Write Your Own (WYO) companies needs to be limited even further. Lowering the current 31.9% allowance to 27.9% on all new policies and renewals when no risk is involved, and of which includes no adjustment expense, is still too high. With over \$56 billion collected in premium since 1978, the companies have been paid almost \$18 billion in allowance! \$3.3 billion was collected in 2016; therefore, the allowance paid was over \$1 billion. NC’s residual market, the eastern NC wind pool, has total expenses – operating, commission and claims adjustment – of about 25% of total premium dollars, just somewhat lower than the admitted market. Congressional Budget Office and Government Accountability reports issued in the years post-Hurricane Katrina included glaring references to the fact that FEMA did not know how much of the allowance was for the actual expenses to manage the program and how much was profit... **Lowering the percentage**, phased in over three years, **is not really going to matter**. It is fundamentally unfair that Congress, with the stroke of pen so to speak, could force homeowners into foreclosure, yet broadly increase the bottom line of the WYO insurance companies.”

Fact: The bill reduces the Write-Your-Own (WYO) allowance by 12.5 percent ($[(32-28)/32 \times 100\%]$).

- A 12.5-percent reduction is significant from the viewpoint of NAR, which also represents a commission-based membership.
- FEMA relies on WYO insurance companies to sell, renew and adjust NFIP policies.
- For this, WYOs receive an allowance for company expenses, agent commissions and state tax.
- Currently, the allowance is 31.9 percent of **chargeable** premium (i.e., total NFIP premium minus the reserve fund assessment and policy fee).
- According to Milliman, this percentage is in-line with homeowner insurance companies, which on average, charge 28 percent of **total** premium.^{43,44}
- NAR cannot identify the referenced CBO report but the bill does address the GAO concerns by reducing program complexity and strengthening accountability and oversight (HR2875).

⁴² Page 34 of <https://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/106xx/doc10620/11-04-floodinsurance.pdf>

⁴³ See the expense exhibit at the end of Milliman’s study: <http://narfocus.com/bilddbatabase/clientfiles/172/19/2912.pdf>

⁴⁴ Note: using FEMA’s illustrative example in 2013 technical documentation, the WYO allowance as percentage of **total** NFIP premium (instead of **chargeable** premium) would be 27.6 percent ($[(= \$2,261 \text{ (agent commission)} + \$316.55 \text{ (tax)} + \$1808.83 \text{ (expense)}) / \$15,871 \text{ (total premium)}] \times 100 \text{ percent}]$). See Section I, Page 5 at <https://www.fema.gov/media-library-data/a10327c71a76f7c88d7cf403dcf60f4f/Actuarial-Methods-and-Assumptions-2013-09-04-508.pdf>

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- The bill would also set the first statutory limit on the allowance in the program's 50-year history; currently, that is completely within FEMA's discretion.

Claim: "Section 102 - Flood Insurance Affordability Program of the legislation references state programs that would address low income homeowners who may not be able to pay for their flood insurance policies. While surcharges to all other program policyholders within the participating state will fund the flood insurance premium this still looks like an expensive administrative proposition. Also, will the WYO's still be paid their allowance on the subsidized policies?"

Fact: Section 102 authorizes optional state affordability programs to reduce NFIP premiums for lower-income homeowners.

- Coastal states have policyholders who cannot afford flood insurance and could benefit.
- While premium reductions would be offset by a surcharge on other policyholders, state participation is voluntary and subject to the approval of the state legislature and governor.
- The bill limits eligibility to a subset of policyholders meeting the following criteria:
 - Residential property and
 - 4 or fewer residences and
 - Owner occupied by an eligible household and
 - Household income less than 150 percent of poverty level or 60 percent of median and
 - With an elevation certificate and
 - Located in flood zone AE or VE and
 - In an NFIP-participating community.
- The subset of policyholders meeting these criteria is very limited but the surcharge would be spread over the broader base of policyholders.

Claim: "All in all, additional measures in the legislation to address the multiple loss properties that constitute only 1% of the program but are responsible for one-fourth of the losses is much needed."

Fact: While the other bill provisions could reduce premiums for coastal property owners, section 504 is the one exception.

- This provision addresses the repetitive loss properties that make up a disproportionate share of NFIP debt (i.e., 2 percent of policies but 25-30 percent of the claims).
- Under this provision, if a policyholder receives three claim payments but makes no effort to mitigate the risk, rates would begin to increase 15 percent per year until reaching full risk.
- 15-percent is less than the current 25-percent increases for second homeowners and business owners but higher than the 6.5 percent for primary residences with no flood claims.
- Nevertheless, if the property owner decides to mitigate before filing the third claim, the property's status is reset to zero so no prior claim payments can count toward section 504.
- The bill would also make all repetitive loss properties eligible for FEMA mitigation assistance, as well as increased cost of compliance, and sets aside and expedite \$1 billion in grant dollars.

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In conclusion, the bill:

- Reauthorize the NFIP for 5 years;
- Limits maximum flood insurance premiums to no more than 15 percent per year for most and \$10,000 for homeowners;
- Preserves the practice of grandfathering for remapped property owners who build to code;
- Removes hurdles to the private flood insurance market, which often offers better coverage at lower cost than the NFIP;
- Authorizes \$1 billion in pre-flood mitigation assistance grants to elevate, flood proof, buyout or mitigate high risk properties;
- Doubles the increased cost of compliance (ICC) coverage in the NFIP policy so policyholders can obtain up to \$60,000 for property mitigation and access these funds before the property floods;
- Better aligns NFIP rates to the risk, particularly for the lower risk and lower value properties inland of the coast;
- Enables more communities to develop alternative flood maps like North Carolina's, which are more accurate than FEMA's, and generally streamlines the map appeals process;
- Improves the claims process in light of problems experienced after Superstorm Sandy;
- Addresses issues with repeatedly flooding properties that account for 2 percent of NFIP policies but 25 percent of the claim payments over the history of the program; and
- Strengthens the overall solvency of the program over the long term.

NAR urges the House of Representatives to bring up and pass the 21st Century Flood Reform Act without further delay.