October 24, 2013

INTERIM REPORT OF THE PRESIDENTIAL ADVISORY GROUP ON CHANGES TO THE NATIONAL FLOOD INSURANCE PROGRAM NATIONAL ASSOCIATION OF RELATORS®

On July 6, 2012, the President signed into law the "Biggert-Waters" Act, reauthorizing the National Flood Insurance Program and providing 5 years of certainty from shutdowns and 40,000 lost home sales per month. The Act will also phase-in the full-risk actuarial rate for 1) older second homes and business properties (sec. 205); 2) purchased primary homes (sec. 205); and 3) newer properties built to code and "grandfathered" under older flood insurance rate maps (sec. 207). These provisions have not been fully implemented, yet property buyers and owners are already reporting significant rate increases in numerous real estate markets across the Nation where flood insurance is required for a mortgage.

A Presidential Advisory Group (PAG) was convened to investigate the rate reports, explore options and review NAR's policy in light of the findings. The PAG met by conference call on Aug. 9, 2013 and in Washington D.C. from Oct. 1-3, 2013 when it heard from key flood insurance experts. Many of the reported increases could be a result of Biggert-Waters, but there was not enough information to determine how many are due to FEMA's new flood maps or state-regulated private insurance in excess of NFIP's coverage. Nevertheless, delaying Biggert-Waters rate provisions could remove the most proximate variable from the rate equation and enable the Congress, FEMA and the industry to evaluate the ramifications without causing undue harm to consumers, communities and markets.

The PAG recommends a staged and multi-prong approach to the flood insurance changes. NAR should redouble its efforts in Congress and also consider any viable legal options to delay sections 205 and 207 of Biggert-Waters until the affordability of these provisions is considered. With some time and breathing room, then NAR would be able to:

1) Work with FEMA to find any flexibility in implementing the rate provisions;
2) Encourage state and local participation in FEMA's rate relief programs; and
3) Leverage NAR resources to educate, research and otherwise take the initiative.

The following lays out the PAG's findings and recommendations in greater detail.

Background

On July 6, 2012, President Obama signed into law a 5-year reauthorization of the National Flood Insurance Program (NFIP) as part of the Biggert-Waters Act (B-W). Before then, the NFIP had operated month-to-month under 18 extensions of previous authority that were tied to government funding bills and the larger political debate over the proper role and size of government. Without this authority, the program could not issue new policies in the +20,000 communities nationwide where flood insurance is required for a federally related mortgage. As a result, NFIP shut down several times, costing 40,000 home sales each month.

In return for a 5-year reauthorization, Congress added two rate reforms to pay back $5 billion of NFIP's Treasury debt (currently $28 billion plus interest) and prevent a possible, eventual default. These reforms will phase-in the full actuarial rate for about 20 percent of policy holders, including: 1) older second homes and business properties (sec. 205) as well as newer properties built to code and "grandfathered" under older flood insurance rate maps (sec.207). In addition, primary homes purchased after July 2012 would no longer be eligible for a subsidized rate (also sec. 205).

While necessary for the continued availability of flood insurance, B-W reforms were implemented without considering the affordability. As a result, property owners across the country are beginning to feel the impact.

- Sec. 205 (Home Sales). On October 1, 2013, the first wave of rate increases went into effect for older second homes, business properties, and primary homes purchased after July 2012. Home sellers have been especially hard hit as the prospective buyers seeing rate quotes well beyond the B-W law have walked away or are refusing to even consider going to the closing table on these properties.
- Sec. 207 (Grandfathering). The next wave of increases could come as early as next year, when the law phases out grandfathering for newer properties. This means the owners will no longer be allowed to keep the lower premium rate associated with the building codes to which they were originally built; instead, their rates will rise with the risk that is reflected in updates to the community's flood insurance rate maps.

And because FEMA has yet to comply with B-W's requirement to report back to Congress by April 2013 on flood insurance affordability, post-reform, we do not yet know the full impact on property owners, their communities or the economy.

In light of this, a Presidential Advisory Group (PAG) was convened to investigate the rate reports, explore options and review NAR policy in light of its findings. The PAG held an organizational conference call on Aug. 9, 2013. From Oct. 1-3, 2013, the PAG met in Washington D.C. to:

- Investigate and determine the scope and source of the rate concerns being reported under the National Flood Insurance Program (NFIP);
- Explore existing rate relief programs at FEMA including the Community Rating System and Flood Map Appeals Process;
- Revaluate NAR's flood insurance policy in light of the group's research and findings; and
- Report its findings to the NAR Leadership Team and, if necessary, to relevant NAR committees of jurisdiction.

The NFIP PAG heard from key flood insurance experts, including:

- David Maurstad, Former NFIP Administrator – to learn more about the program's goals, workings and challenges. Maurstad explained that Biggert-Waters was passed to prevent a debt default; the program now owes $28 billion plus interest to the federal treasury. When asked what would happen if a major state pulled out of NFIP, he believed that the other 49 would continue to pay in enough to cover the claims for those 49 states, but the one pulling out could face billions in new liability.
- Lisa Jones, Principal of Carolina Flood Solutions and Former State Floodplain Manager – to explain the nuts and bolts of how flood insurance rate quotes are developed. Jones covered how B-W is being implemented and identified several possible causes of reported increases, including insurance mis-rating mistakes. For example, one buyer received 6 quotes ranging from $10,000-$35,000/year for a single home, because all 6 (including 3 from one company) input incorrect information about the property's construction date, elevation, CRS discount and eligibility for grandfathering. The true rate turned out to be only $400. Jones also noted there is no one in the federal government to whom this or other homebuyers could turn for help.

- Kelli Walker, Senior Government Affairs Director for the New Orleans Metro. Association of Realtors®; and Larry Larson, Former Executive Director of the Association of State Flood Plain Managers -- to explore existing FEMA programs to help communities discount flood insurance rates. Both discussed their experience with these programs and how to use and streamline them to provide some immediate rate relief without requiring another act of Congress.
- Eli Lehrer, President, R Street Institute – to talk about private market alternatives to NFIP. Lehrer stated that the B-W reforms were designed to move the NFIP toward privatization. While there may be good reasons for NFIP (including that the private market cannot turn a profit on flood insurance), he asserted that eventually the NFIP will end. The PAG strongly disagreed, and opposes privatizing flood insurance or terminating the NFIP.

Recommendation #1: Delay Biggert-Waters Rate Reforms
The flood insurance experts with whom the PAG met identified several possible causes of the rate increases being reported, including FEMA's ongoing flood re-mapping or insurance issues. It was not possible from available information to pinpoint the exact cause in every rate case. Nevertheless, the most proximate source would be B-W sec. 205 that took effect Oct. 1, 2013, and prohibits rate subsidies for any home purchased after July 2012. Unlike the other properties which are slated for a gradual increase, these homebuyers will see the full increase to actuarial cost upon point of sale or the first policy renewal after Oct. 1. Because FEMA waited nearly 9 months after the effective date to implement the purchase provision and another 5 months before making it effective, some bought their home not knowing that they were paying a subsidized rate and these subsidies are phasing out the next year. Delaying this B-W provision as well as sec. 207 (phasing out grandfathering) would provide Congress, FEMA and industry with time and breathing room to get to the bottom of the rate increases. The delay should last for as long as necessary for the policy makers to consider the B-W law's affordability even if it extends into the next session of Congress.

In addition to redoubling efforts on Capitol Hill, NAR should consider:

- Engaging NAR's Legal Team to consider any viable legal options to delay B-W, including the recent lawsuit by Mississippi's insurance commissioner against the federal government;
- Activating NAR's Grassroots, including providing talking points or other calls for action for state and local boards to enlist the help of governors and state legislators;
- Educating Congress, Administration and the public about the impact of the rate increases on property owners, surrounding communities, taxpayers and the broader economy;
- Expanding NAR's coalition to include consumer, elderly or other groups that are hardest hit by the increases;
- Reaching out to state insurance commissioners and associations to discuss insurance agent training and accountability, which has also contributed to the rate increases; and
- Further investigating FEMA's actuarial rates (e.g., how can there be only one "A" zone rate schedule where a homeowner in the Midwest would pay the same as another in the Gulf?), and seeking additional credible examples upon which Congress and FEMA can act.

Recommendation #2: Work with FEMA to find flexibility in implementing Biggert-Waters
FEMA may have administrative discretion to minimize the impacts of implementing B-W.

- For example, FEMA unilaterally decided to wait nearly 9 months after the effective date to implement sec. 205's purchase provision and then another 5 months after before making it effective. FEMA's general counsel probably signed off on this decision; perhaps there is additional administrative flexibility there.
- Certainly the decision to delay then retroactively apply sec. 205 to homes purchase over the past year has only added to the confusion and uncertainty harming many real estate markets. FEMA bears some responsibility for poor implementation decisions.
- Similarly, FEMA has not interpreted whether sec. 207 (i.e., phasing out grandfathering) will apply to primary homes that are exempt under sec. 205 or whether that provision will apply retroactively to July 2012. We do not know which grandfathered properties will be subject to a 5-year phase out. FEMA may be able to clarify these issues without prompting further congressional action.
- Furthermore, FEMA has yet to issue key regulations under B-W that could help with flood insurance affordability – e.g., giving partial credit for protection from unaccredited dams or levees; and providing for installment payments (sec. 205), the reimbursement of flood map appeal expenses, and the COASTAL formula to help resolve wind vs. water claims.
- The Agency can improve upon its education efforts, including more targeted public service announcements, as well as the accuracy and precision of its estimates of B-W's impact. We do not know how many properties have been grandfathered, or what percentage of the full actuarial rate that subsidized policyholders have paid to estimate the financial impact.
- Elevation certificates provide accurate property information to keep property owners from being over-charged for flood insurance. But they must be completed by licensed surveyors which can be expensive. Perhaps there are lower cost options such as GPS devices in lieu of surveyors to make these certificates more affordable.
- Finally, FEMA has not submitted its statutorily mandated affordability report under B-W sec. 236, without which Congress lacks vital information that could lead to better NFIP decision making.

NAR should call for a National Summit with FEMA that includes Realtors®, homebuilders, private insurers, bankers, floodplain managers and other key stakeholders to work together and identify any administrative flexibility and minimize uncertainty in implementing the B-W changes going forward.

Recommendation #3: Encourage State/Local Participation in FEMA rate relief programs

- FEMA's Community Rating System (CRS) is a voluntary program for communities to earn discounts of 5-45% discounts off their flood insurance through a variety of flood education and mitigation activities.
- There are also several mitigation grant programs for the buyout or elevation of properties that could be streamlined or expedited to property owners affected by B-W.

These FEMA programs could offer immediate rate relief without additional legislation. Yet, few communities or property owners take advantage of them. Some of the reason may be red tape and bureaucracy, and NAR should work with FEMA to help simplify and streamline the paperwork and other requirements so more communities can join, understand and resolve their program disputes. NAR has smart growth grants and brochures jointly with FEMA which might be used for credit. NAR could also create partnerships with local chambers of commerce or other groups to get them involved in community ratings. NAR should explore this or any additional resources it can bring to encourage state and local chapters to either join these programs or encourage their communities to.

Recommendation #4: Leverage NAR resources to educate, research and take the initiative
NAR should not wait on Congress or FEMA to act. To be proactive, constructive and part of the solution, NAR could:

- Undertake its own affordability study if FEMA cannot meet the B-W mandate in a timely manner;
- Establish an NAR certification or offer continuing education courses on flood insurance;
- Hold forums at the San Francisco Convention and invite FEMA and other flood insurance experts;
- Emphasize Realtor® training and consider including as the first step encouraging clients to obtain elevation certificates even if it costs home buyers; also, explore whether NAR can assist with local efforts to provide free elevation certificates for those buyers. See, e.g., http://www.freeelevationcertificate.com/
- Write human interest pieces on the hardest hit homeowners and communities;
- Develop Public Service Ads or provide Smart Growth grants to local boards for the same;
- Develop brochures a) Demystifying FEMA's map appeals process and b) identify common flood insurance pitfalls when building or improving property;
- Engage the Realtors® Property Resource to provide more information on the flood risk to properties;
- Develop a case study of the most egregious rate increases and local solutions; and
- Explore options including multi-peril and community-based flood insurance.

NAR should take the initiative whenever possible to help provide for affordable flood insurance.