NAR Issue Brief
The 21st Century Flood Reform Act
H.R. 2874

NAR FREQUENTLY ASKED QUESTIONS:
The 21st CENTURY FLOOD REFORM ACT (HR 2874)

The National Flood Insurance Program (NFIP) provides necessary flood protection and coverage for 5 million policyholders across 22,000 communities nationwide. However, the NFIP is currently running a $1.4 billion annual deficit,[1] and accumulated a $24.6 billion debt after weathering a series of catastrophic loss years since 2005.[2] The program is up for reauthorization on September 30th.

NAR urges the House of Representatives to bring up and pass **HR 2874: The 21st Century Flood Reform Act** upon returning in early September. The bill meets all six of NAR's reform principles.[3] It would reauthorize the program for 5 years, stabilize its financial position, and make numerous and significant improvements to current law. Following are NAR responses to questions about the bill.

FREQUENTLY ASKED QUESTIONS

Why should Congress pass the 21st Century Flood Reform Act?

- Reauthorizes the NFIP for 5 years;
- Limits maximum flood insurance premiums to no more than $10,000 per year for residential properties;
- 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 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 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
- Overall strengthens the solvency of the program over the long term.

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[1] See Congressional Budget Office's 2017 preliminary analysis of NFIP at: https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/52638-nfipletter.pdf

[2] The program had to borrow in 2005, 2012 and 2016 in order to cover the shortfall between premiums and claims. While the impact of Hurricane Harvey won't be known for weeks, based on early news reports, 2017 could mark the first time in NFIP's 50-year history that the program will experience two back-to-back catastrophic loss years -in a row.

[3] For NAR's reform principles: http://narfocus.com/billdatabase/clientfiles/172/22/2551.pdf

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Why not just reauthorize the NFIP without major reforms?
As currently structured, NFIP is unsustainable over the long term. According to the Congressional Budget Office (CBO),[4]

- NFIP premiums fall $1.4 billion short of expected annual costs, including all potential flood events, not just the ones FEMA counts.
- As of March 2017, the NFIP has borrowed $24.6 billion to make claim payments for hurricanes in 2005 (Katrina) and 2012 (Sandy), and inland flooding (Baton Rouge) in 2016.[5]
- According to the CBO, the program is expected to borrow at least another $1 billion over the next 10 years and there is only $5 billion left on its borrowing authority (just over $30 billion). These numbers do not account for claims expected to result from Hurricane Harvey.
- The NFIP is not able to repay the $25 billion already borrowed and is making interest-only payments.
- Interest on the debt costs NFIP policyholders $300 million per year -- funds not available for other purposes including paying claims or improving flood mapping.
- Approximately 25 percent of NFIP policies are subsidized and paying rates below full cost.
- Less than 2 percent of 5 million policyholders flood repeatedly (two or more times) but account for more than $8 billion or 25 percent of the claims and one-third of NFIP's $25 billion debt;
- Because NFIP sets national average rates, many lower risk or lower value properties, especially those inland of the coast, are overcharged for flood insurance while others are undercharged.

Will NFIP rates increase under the bill?
While the majority of policyholders are expected to see no change or a small rate decrease, the highest risk and highest value properties, particularly those that flood repeatedly, could see an increase. However, increases would be phased-in gradually over many years. Increases are capped at 15% a year under the bill. The bill also includes a new cap on premiums so no homeowner would pay more than $10,000 per year maximum for flood insurance.

Additionally, more than $1 billion in mitigation grant dollars is set aside under the bill for property owners to elevate, flood proof, buy out or relocate, and thereby reduce their risk-based NFIP rate. Elevating a home by just two feet can cut the NFIP rate by as much as two thirds.

What does Section 104 (coastal and inland locations for NFIP rates) do?
This provision would direct FEMA to develop NFIP rates for coastal and riverine areas, <u>and inland</u>. Currently, NFIP has two risk-based rate tables – one for properties subject to <u>more than</u> 3 feet of storm surge (V zones) and one for everyone else (A zones). According to the CBO, this means that "owners of homes that are subject to [up to 3 feet of] wave damage from storm surge do not pay higher premiums that reflect additional risk; instead, they pay according to the same rate schedule that is used for homes that

[4] CBO, 2017: https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/52638-nfipletter.pdf
[5] On March 9, 2017, Deputy Administrator Roy Wright testified before the House Financial Services Committee that NFIP borrowed another $1.6 billion in January to make the March interest payment.

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are not exposed to wave damage. The result is an implicit cross-subsidy from inland homes to coastal homes…"[6]

By developing inland rates for coastal properties and considering such risk factors as "distance to coast," NFIP would move toward a more granular rating system like an insurance company's. This means that rates would generally decline with the risk as one gets further away from the coast, and vice versa. In many cases, coastal properties not subject to storm surge risk could pay less. It would also mean that homeowners in Winslow, AZ, would not pay the same rate as those just blocks away from the coast in Miami, FL. However, under this provision, increases would be subject to annual limitations so no homeowner could pay more than a 15-percent increase in any given year (down from the current law of 18 percent) or $10,000 maximum.

NAR policy supports fair flood insurance premiums, which reduce cross subsidies and better aligns with property specific risk. NAR specifically requested that section 104 be added based on an NAR-sponsored Milliman actuarial analysis of the NFIP. This study found that inland policyholders in counties including Pinellas, FL, could pay thousands of dollars too much for flood insurance while others closer to the coast pay thousands less.[7] Milliman has recently been hired by NFIP to explore a redesign of its risk rating structure, so the NAR analysis could help illustrate the potential benefits and costs of such a provision.

What about Section 504 (repetitive loss properties)?
Section 504 would address the 90,000 structures -- 2 percent of 5 million NFIP policies -- that have repeatedly flooded two or more times and received more than $8 billion in claim payments since 1978. According to a Natural Resources Defense Council (NRDC) analysis of FEMA data, these properties have received an average of five claim payments totaling $181,000, and 75 percent have not taken any action to mitigate the risk of further claims.[8]

Under the Biggert-Waters Act, NFIP rates increase 25 percent per year for repetitive losses that are "severe." However, the majority of these properties have avoided the 25-percent increases by either filing numerous smaller claims (so no four exceed $5,000) or two very large claims averaging $55,000 each[9] but totaling less than the value of the structure. If rates do not increase with claims, there is less incentive to mitigate and the program becomes more expensive for other policyholders. Also, because of the flawed Biggert-Waters definition, many of these property owners would not qualify for FEMA mitigation grants -- even if they wanted to reduce their risk of flooding.

Section 504 would close the loopholes and make mitigation grant assistance available by redefining the term "repetitive loss" simply as "two or more claim payments of any amount." However, no one would see a rate increase under the bill unless/until the property owner receives at least three claim payments, including at least one after the date of enactment. The bill would also reset the property's claim status if

6 Page 5 of https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/52638-nfipletter.pdf
7 For the Milliman study: http://narfocus.com/billdatabase/clientfiles/172/19/2912.pdf
8 https://www.nrdc.org/experts/rob-moore/flood-rebuild-repeat-need-flood-insurance-reforms

9 From 2000-2009, the average NFIP payout was $55,000 but ranged from a low of $14,000 (2000) to a high of $91,000 (2005). See Table 2 of http://opim.wharton.upenn.edu/risk/library/J2015JORI_Flood-Insurance-Claims_CK-EMK.pdf

mitigated, so no claims made prior to mitigation are counted. If a property owner nevertheless decides to file more claims without mitigating, their NFIP rate would begin to increase 15 percent per year – increases already allowed under current law[10] -- until reaching full risk. This is less than the 25-percent increases for second home and business owners but higher than the 6.5-percent increases for primary residences with zero claims.

By redefining repetitive loss as two or more payments, section 504 would also make all repetitive loss properties eligible for both flood mitigation assistance and increased cost of compliance, and set aside more than $1 billion in grant dollars. The bill removes paperwork, red tape and bureaucracy so FEMA can directly provide or expedite these grants to the owners, and waives NFIP's current cost sharing requirement, i.e., repetitive loss properties will no longer have to pay 10 percent of the cost in order to receive a FEMA grant.

Does section 504 apply to any two claims of any amount?

No, Section 504 would apply only if there are three claim payouts – either two in the past and one in the future, or one in the past and two in the future. It is **not** "any claim of any amount;" it is any claim **payment** of any amount that exceeds the policy's deductible. Deductibles for homeowners can range from $1,000-$10,000 so any claim for less than this would not count toward Section 504.

While the bill language is less clear on what happens to future repetitive loss properties with zero past claims, the bill sponsors' intent is at least three claim payments before the section applies. NAR is working with the sponsors to tighten the language so there is no room for interpretation.

Would the NFIP rate go to full risk upon the second claim?

No, the property owner must file at least one more claim in the future before any premium changes take effect. The owner would also have access to grants and an opportunity to wipe the slate clean via mitigation. If the owner however chooses to file more claims before mitigating, the NFIP rate would begin to rise 15 percent per year until the owner pays full risk. The rate could not exceed $10,000 per year for residential properties.

Will repetitive loss properties lose their grandfathered status?

NAR supports grandfathering for property owners who build to code. According to FEMA, most repeatedly flooding properties were built **before** there were flood maps or codes (i.e., pre-FIRM). Moreover, the vast majority have been substantially flood damaged (i.e., damage exceeds 50% of the building's value), which would render them not eligible for grandfathering under current law.[11]

In fact, this bill would enable repetitive loss property owners to grandfather, not the reverse. Under the bill, if an owner mitigates to code, the property's status would reset so it could grandfather to the map at the time of mitigation when that map is updated in the future.

[10] See 42 USC § 4014(e)(1).
[11] See esp. Table A1: https://www.nrdc.org/sites/default/files/climate-smart-flood-insurance-ib.pdf

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Do repetitive loss properties lose pre-FIRM subsidies?
Pre-FIRM subsidies are already being phased out under current law; section 504 would not change this. Under the legislation, NFIP rates for severe repetitive loss properties, non-primary residences and business properties will continue to increase 25 percent per year until reaching full risk (same as current law); the primary residences will increase 6.5 percent. What section 504 does is raise the rate to 15 percent per year (instead of 6.5 percent) if a primary homeowner receives at least three claim payments, including at least one after bill signing.

Would the bill eliminate NFIP coverage for repetitive loss properties?
Only for the most extreme repetitive or excessive lifetime loss claims.

- Section 504 would discontinue NFIP coverage **if** a repetitive loss property submits at least three claims, the sum of all claim payments exceeds **1.5 times** the NFIP's coverage limit for structure ($525,000 for a residential property), **and** the owner refuse to mitigate.
- Section 505 would discontinue coverage if the sum of all claim payments received in the future (beginning 18 months after bill signing) exceeds **2 times** the value of the building (e.g., if a $500k structure cumulatively receives more than $1 million in NFIP payments for floods after 2020).

It is unlikely that any property owner would choose to file additional claims knowing that the next one would trigger either of these thresholds and force the NFIP to drop coverage.

Why are these changes necessary?
As currently structured, the NFIP is not sustainable over the long run. While the bill does make some difficult choices, the changes are the minimum necessary to close the $1.4 billion shortfall between premiums and claims. The bill could have gone farther to address the $25 billion debt but did not. Sacrifices are shared by policyholders over time so no one group would bear the full burden. Does this mean that a handful of policyholders might see higher rates? Yes. Does this bill provide financial and mitigation assistance for those who could be hardest hit? Yes. If the program is reauthorized without major reforms, will there continue to be an NFIP in the future? There are no guarantees.