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

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

NAR urges the House of Representatives to bring up and pass HR 2874: The 21st Century Flood Reform Act. The bill meets NAR's six principles for flood insurance reform.[1] It would make significant improvements to current law. Without these changes, the National Flood Insurance Program (NFIP) will continue to be a broken program.

- Reauthorizes the National Flood Insurance Program (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 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 flood mitigation grants to elevate, buyout or mitigate high risk properties;
- Doubles Increased Cost of Compliance (ICC) coverage in the NFIP policy, which policyholders can use for property mitigation, and allows access to ICC prior to floods;
- Better aligns NFIP rates for lower risk and value properties inland of the coast to their true risk;
- Provides for communities to develop more granular, alternative flood maps to FEMA's and streamlines the community 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; and
- Overall strengthens the solvency of the program in the future.

Why do we need to reform the NFIP? Why not just reauthorize it long term?
According to the Congressional Budget Office (CBO),[2] the NFIP is operating at an annual deficit of $1.4 billion each year and is not fiscally sustainable over the long term.

- Currently, NFIP premiums fall $1.4 billion short of expected annual costs, including all potential flood events and 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.[3]
- According to the CBO, the program is expected to borrow at least another $1 billion over the next 10 years.
- 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 that are not available for other purposes like paying claims or improving flood mapping.
- Approximately 25 percent of NFIP policies are subsidized and paying rates below full cost.

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[1] http://narfocus.com/billdatabase/clientfiles/172/22/2551.pdf
[2] https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/52638-nfipletter.pdf
[3] On March 9, 2017, Deputy Administrator Roy Wright testified before the House Financial Services Committee that NFIP borrowed another $1.4 billion in January to make the March interest payment.

- Less than 2 percent of the 5 million policyholders flood repeatedly but account for more than $8 billion or 25 percent of the claims since 1978.
- Because NFIP sets national average rates, which don't account for risk factors such as storm surge in coastal A zones, many lower risk, lower value, and inland properties 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 value properties, particularly those that flood repeatedly, could see an increase. However, increases would be gradual over time and no homeowner would pay more than $10,000 per year for flood insurance.

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

What is Section 104 of the bill (coastal and inland locations NFIP rates)?
This provision would require FEMA to provide NFIP rates for coastal and riverine areas, and inland.

Currently, NFIP has one risk-based rate table across all A zones, including coastal A zones. This means that "owners of homes that are subject to 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 are not exposed to wave damage. The result is an implicit cross-subsidy from inland homes to coastal homes…"[4]

Creating rates for all locations would mean that the NFIP would move towards a rating system more like a private insurance company's. The program would have to consider risk factors like "distance to coast" and "relative land elevation," so in many cases, rates would generally decline for A-zone properties as you get further away from the coast and increase as you get closer to the coast. It would also mean that homeowners in say, Winslow AZ, would not pay the same rate as a homeowner blocks away from the coast in Miami, FL.

NAR policy supports a more granular and fair flood insurance rating system, which reduces 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 are paying thousands of dollars too much for their flood insurance while other policyholders closer to the coast paid thousands less.[5] Milliman has just been hired by NFIP, which is exploring reforms of its risk rating structure, so this NAR-sponsored analysis could help illustrate the potential benefits and costs of this provision.

What is Section 504 (repetitive loss properties) and what does it do?

Repetition [rep-i-tish-*uh* n] (noun): 1. The act of repeating, or doing … something again.

[4] Page 5 of https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/52638-nfipletter.pdf
[5] http://narfocus.com/billdatabase/clientfiles/172/19/2912.pdf

Section 504 would address the 90,000 repetitive loss properties that make up 2 percent of NFIP policies that have received $8 billion in claim payments since 1978. This total represents one quarter of the $15 billion NFIP has borrowed from taxpayers. According to a Natural Resources Defense Council (NRDC) analysis of FEMA data, the typical repetitive loss property has received five claim payments totaling $181,000.[6]

The Biggert-Waters Reform Act raised NFIP rates by 25 percent per year for repetitive losses that are "severe." However, the majority of these properties have evaded the 25-percent increases by filing numerous smaller claims so no four exceed $5,000 or filed just two claims summing to just under the replacement value of their home. Also because of Biggert-Waters' flawed definition of "severe," many of these properties do not qualify either for FEMA mitigation assistance (FMA) grants or increased cost of compliance (ICC) coverage.

Section 504 would close this loophole 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 not see a rate increase under this bill unless/until the 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, once mitigated, so no claims made prior to mitigation are counted. If nevertheless the property owner choses to file more claims without mitigating, the NFIP rate would begin to increase 15 percent per year – which is already allowed under current law -- until reaching full risk. It should be noted that this is less than the 25-percent increases for severe repetitive losses, second home and business owners but higher than the 6.5-percent increases for primary residences with no claims.

By redefining repetitive loss as two or more payments, section 504 would also make all repetitive loss properties eligible for both FMA and ICC, 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 the 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. And it's <u>not</u> "any claim of any amount;" it is any claim <u>payment</u> of any amount that exceeds the policy's deductible. Deductibles for homeowners can range from $1,000-$10,000 so a claim of, e.g., $500 would not count toward section 504.

While the bill language is less clear on what happens to properties with zero past claims, the bill sponsors' intent is that there would have to be at least three future claim payments before the section applies. NAR is working with the sponsors to tighten this language so there would be 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 bill changes take effect. The owner would also have access to grants and an opportunity to wipe the slate clean thru mitigation. If the owner however chooses to file more claims without mitigating, the NFIP rate would begin to rise 15 percent per year until the owner is paying full risk. However, the rate could not exceed $10,000 per year for residential properties.

[6] https://www.nrdc.org/experts/rob-moore/flood-rebuild-repeat-need-flood-insurance-reforms

Will repetitive loss properties lose their grandfathered status?
NAR supports grandfathering for properties that build to code. According to FEMA, 90 percent of the repeatedly flooding properties were built before there were flood codes or maps (i.e., pre-FIRM). Moreover, 79 percent of these properties have been substantially flood damaged (i.e., the damage exceeds 50% of the building's value), which renders them not eligible for grandfathering under current law.[7]

In fact, this bill would enable repetitive loss property owners to grandfather in the future, not the reverse. Under the bill, if these owners were to mitigate to code, the property's status would reset so it could grandfather to the flood map in effect at the time of substantial improvement when the map is updated in the future.

Do repetitive loss properties lose pre-FIRM subsidies?
Pre-FIRM subsidies are already phasing out under current law; section 504 would not change this. For the severe repetitive losses, business properties and non-primary residences, NFIP rates will continue to increase 25 percent per year until reaching full risk. 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. The bill would also provide mitigation grants and cap the NFIP rate at no more than $10,000 a year.

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

- Section 504 would discontinue NFIP coverage if an extreme repetitive loss property owner submits 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 lifetime claim payments are excessive such that sum of all payments made after 18 months in the future exceeds 2 times the replacement value of the building (e.g., $1 million in payments for a $500k structure).

It is unlikely that any property owner would choose to file more claims knowing that one more would force 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 $1.5 billion shortfall between premiums and claims. The bill could have gone farther to address the $25 billion debt but did not. Sacrifices are shared and spread evenly 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? Also yes. If the program is reauthorized without no significant changes to the financial situation, will there continue to be an NFIP in the future? NAR cannot guarantee that.

[7] https://www.nrdc.org/sites/default/files/climate-smart-flood-insurance-ib.pdf