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Flood Insurance Affordability

ASFPM Recommendations to address the impact of NFIP Reform 2012 (BW-12)

ASFPM supports many of the provisions of the 2012 NFIP Reform bill, otherwise known as Biggert-Waters 2012, usually shortened to BW-12. A centerpiece of this reform bill was to make the NFIP more financially sound. At the time the bill passed (May 2012) and was signed (7-6-12), the NFIP was over $17 billion in debt to the US Treasury (taxpayer), with little chance the program could ever repay that debt (now, the program is $23 billion in debt to the Treasury , [expected to go to $25 billion as a result of Sandy]). As such, Congress looked closely at why the program was in debt and what could be changed to improve it. The changes include many provisions for significant increases in flood insurance premiums to move them toward full risk rates and other measures to improve the financial soundness of the NFIP. ASFPM supports fiscal soundness for the NFIP.

What the legislation did not address is the effects of the changes on policyholders and the affordability of flood insurance policies for those that truly cannot afford the increases. While there was a study included in BW-12 to examine affordability issues; it had no implementation mechanism. There are now a number of bills being proposed that would roll back the premiums or lengthen the time policyholders would have to move to full risk premium rates. This paper discusses BW-12, the need for a financially sound NFIP, and the options to address the affordability issue for lower income people who may not be able to afford the rate increases or for those who may need time to adjust to the premium increases.

ASFPM suggested principles related to flood insurance affordability

Just like solutions to complex flood problems, the solution to the affordability issue must be met through multiple approaches. While the subset of those policies most affected by premium increases is a minority of the entire policy base, (19.3% of policies are discounted), the impact of the increases will be significant to those affected. <u>The following principles have been identified by ASFPM as those which would improve financial stability while also addressing affordability issues as BW-12 is implemented:</u>

1. **The policy holders and those impacted by Hurricane Sandy should not be treated differently with respect to premiums than those in flood hazard areas in the rest of the nation.** In fact, because of post-disaster mitigation programs and other assistance, those in Sandy and other recent Presidentially-declared disaster areas will have more opportunities for financial and technical assistance to take steps to reduce future flood insurance rate increases.
2. **Flood insurance premiums must move toward full-risk rates in order to show property owners the true flood risk they face (so they can make informed decisions) and to put the NFIP on sound financial footing.** The issue is how much and how fast. BW-12 sets a 4-5 year schedule to move various classes of policies to full-risk rates. This “glide path” to full-risk rates could be evaluated to determine impacts. Also, while BW-12 purported to shield primary residences from the impacts of the discount reduction, some provisions will actually have a significant impact on primary residences. The most dramatic of

those provisions is the movement to actuarial rates on the sale or transfers of pre-FIRM properties and that should be fully evaluated to see if its impacts need to be addressed.

3. **Not all existing property owners with discounted rates will be able to afford full actuarial rates, so some means tested program to assist in transitioning them to either full-risk rates or better yet, to mitigate their structure, will be necessary or some people may be priced out of their home.** Such programs could include a system whereby assistance is provided to pay for some of the increase in flood insurance premiums. This could be a sliding scale from picking up all or most of the premium increase to picking up none of the increase, based on income status. This should be set up so the subsidy does not reduce the income to the NFIP, and must result in the property owner seeing the full risk flood insurance rate so they are made aware of their flood risk and the full risk rate; and then the voucher is applied.
4. **Flood insurance rating should be revaluated and refined to better reflect both risk and recognize partial mitigation if such mitigation is found to be effective.** In the early days of the NFIP, more variation in flood insurance rating was used, but given certain concerns from the insurance side, the rates where consolidated. Given today's computerized environment and flood risk data available, consideration should be given to reinstating variable risk factors or similar refinements. For example, a recently released report by the National Academies of Sciences recommends refined rating zones in areas protected by levees.

   Another rating issue is the concept of credit for mitigation measures that do not achieve full building compliance. FEMA should analyze its claims data to determine if there can be recognition of partial mitigation options to reduce premiums, especially for pre-FIRM structures. Such measures might include elevation or relocation of utilities and other mitigation options if they truly reduce claims to the NFIP. Also, special consideration should be given to pre-FIRM structures (homes) that cannot be mitigated (elevated or relocated) due to location or structural deficiencies to the existing building and have been certified by a design professional as such. In this case, and for certain construction types of structures, additional mitigation options such as water-tight doors and windows (if applicable) might be able to be recognized as providing an additional level of protection and flood insurance rates could reflect that increased level of protection accordingly, if certified by a design professional as truly reducing future claims.
5. **Develop innovative and new flood insurance approaches, such as community-based insurance and long-term policies that stay with a structure and can assist in financing mitigation.** The benefit of a community-based policy is that the local unit of government, flood district, or levee district can assess all properties benefitting from community mitigation measures. Furthermore, since the rating would be on a community basis versus parcel basis, there is more equity in future rate increases or decreases because it is usually the community, not the property owner, that makes future development or neighborhood type decisions that either increase or decrease risk in the community. Long term policies would stay with the property, not the owner, so that the flood policy does not get dropped, leaving the property owner with only limited taxpayer disaster relief when trying to recover.
6. **Fully utilize and refine existing hazard mitigation programs to address flood insurance affordability.** There are several existing hazard mitigation programs that can be brought to bear on the flood insurance affordability issue:

   - The Hazard Mitigation Grant Program (HMGP) from FEMA, as well as HUD, EDA and other post disaster programs are extremely important cost sharing programs to assist mitigating damaged structures after a federally declared disaster, and as Sandy demonstrated, must be adequately resourced to help protect lives and property, as well as address the insurance affordability issue.

- FEMA's Flood Mitigation Assistance (FMA) programs to mitigate repetitive losses are also key to mitigation, and need to be resourced and streamlined so property owners know their options.
- Pre-Disaster Mitigation (PDM) grant programs provide grant funds to mitigate existing at-risk buildings and develop community mitigation plans before the disaster occurs. In states that have not experienced a disaster, but where thousands of property owners will experience increased premiums, this program will be especially key, and must be adequately resourced;
- Increased Cost of Compliance (ICC) is part of the flood insurance policy that provides mitigation funds directly to property owners after a damaging triggering event;
- The Community Rating System (CRS) provides community-wide (all policyholders in the community in the SFHA or standard-rated Zone X policies) discounts on flood insurance premiums for measures the community takes that go beyond minimum standards for actions that will reduce future flooding and claims; and
- The Community Assistance Program (CAP-SSSE) provides technical assistance and training to communities participating in the NFIP.

<u>First, all of these programs need to be fully resourced.</u> Some of the existing programs must be made more efficient (e.g., more quickly deploying HMGP funds), some must increase resources available to handle a significant increase in interest that will be driven by higher insurance rates (e.g., CRS program application assistance, pre-disaster mitigation grant programs), and some must be refined to bring more resources to bear on the affordability issue (e.g., raise limits on ICC and fully implement the current law to trigger ICC upon an offer of mitigation). Technical assistance programs such as CAP and others (even from outside of FEMA like the Corps of Engineers Silver Jackets, Floodplain Management Services and Planning Assistance to States programs) will become more important as property owners and communities seek solutions and technical advice on measures to explore, evaluate and implement options to reduce flood risk and insurance costs.

7. **Evaluate and implement changes in the tax code to incent mitigation.**
   Current tax code provisions provide tax breaks for uninsured losses, and there are considerations to provide credits for flood insurance premium increases. Both of these send precisely the wrong message and take away the motivation for individuals to take responsibility for their actions. A much better use of the tax code would be to provide tax credits of other incentives for actually mitigating at risk structures. Such a program could be modeled after those used for energy efficiency and/or special provisions made to write off the cost of mitigation measures for disaster affected property owners. Tax breaks for real estate taxes can also be given by local governments to those who mitigate—this has been done in some communities.

BACKGOUND ON BW-12 PROVISIONS

Issues and program processes leading to the NFIP debt prior to passage of BW-12 included:

1) The percentage of the properties in the mandatory flood insurance purchase areas (SFHA) actually have flood insurance was very low (about 50%), which was a concern to the program and Congress.
2) A couple of groups compose discounted policies
   a) About 20% of the NFIP policies are Pre-FIRM structures which receive discounted (subsidized) rates and they pay about 40 to 45% of full risk rates. Currently, of the 5.6 million NFIP policies, there are a total of 1,082,201 (approximately 19.3%) of the policies that are Pre-FIRM discounted policies, and of that amount, roughly 600,000 are primary residential structures, leaving about 400,000 policies for other properties that were getting discounted rates.
   b) Structures that were grandfathered at the discounted rates included those that were built before the community flood map was effective (pre-FIRM) and those who were placed into the SFHA because the map was updated to better reflect the changing risk.
3) There was no reserve fund in the NFIP to cover the fund for catastrophic losses like Katrina or Sandy
4) Current flood insurance rates did not adequately reflect the actual flood risk; annual ratemaking didn't sufficiently account for large flood events.

Measures in BW-12 to address these funding deficiencies include:

1) To address #1 above, BW-12 increases the penalties for lending institutions that fail to ensure borrowers maintain their flood insurance policy. Lender penalties for non-compliance with mandatory flood insurance purchase requirements is increased from $350 to $2000 per violation, and the limit of fines for any lending institution over a calendar year is removed (it was $100,000). Removal of the cap may be an effective tool for improving lender compliance. FEMA will need to work with lenders to compare databases and see who is not covered and should be.
2) To address #2, these changes were included in BW-12:
   a) Discounted policies losing their discount include non-primary residences (e.g., second homes), severe repetitive loss properties, all business properties, and homes which have had substantial damage or improvements. About 400,000 non-primary homes will move toward actuarial rates with a permissible increase of 25% per year until full-risk rates are achieved. Additionally, in the Sandy affected area there will be somewhere between 30,000 and 40,000 substantially damaged structures, and untold numbers throughout the nation, which will move toward actuarial rates, whether primary residential structures or not. In addition, pre-FIRM properties that on or after July 6, 2012 have a new policy written on them or are newly purchased or had a policy and it lapsed and a new one is written, will be written at full-risk rates.
   b) BW-12 calls for eliminating grandfathering and replacing it with a 20% increases for 5 years starting in October 2014. FEMA has not yet been determined how to implement this provision.
3) BW-12 requires FEMA to build a reserve fund, and FEMA now indicates premiums on all policies are being increased 5% to build a reserve fund.
4) BW-12 allowed FEMA to raise rates on classes of structures up to 20%/year (it was 10%/year prior to BW-12).