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National Flood Insurance Program Reauthorization and Reform

By Ed Thomas and Joe Rossi

This article is an effort to inform attorneys practicing state and local government law of issues concerning the National Flood Insurance Program (NFIP) and to raise awareness of the concept of resilience, avoiding or reducing the risks of flooding disasters through climate adaptation and hazard mitigation.

Recent flood disasters nationally have attracted more attention to proposals in the current Congress to reauthorize the NFIP that consider policy changes and deal with the program's accumulated debt. There has been growing interest in the idea of "resilience," in the misery and mounting economic and environmental cost following hurricanes and other flood disasters, in wildfires in the United States and worldwide, in water quality issues and the huge numbers of tornadoes in the past few years. The American Bar Association passed a Resolution concerning resilience in the context of disaster risk reduction in 2017.[1]

Noted demographer Dr. Arthur C. (Chris) Nelson has demonstrated that fully one-half of the square footage of improved property that will exist in the United States in 2050 does not exist today. This presents an opportunity to correct patterns of property development before they become disasters. Aristotle famously observed that "well begun is half done." A better motto might be "half done is very well begun!" Constant demands for more federal, state, and local funds to correct past mistakes of planning and community development that contributed to disasters following foreseeable natural events is a not a sustainable path. The better approach for funding disaster prevention simply is to plan, design, and build so that those foreseeable events do not devastate persons and property.[2]

Flooding is both one of the most predictable and unpredictable forces in nature, due to limitations on predictive capability and the ever-changing nature of human activity, such as development that changes permeable soils to impermeable, failure to maintain stormwater management systems, and a changing climate. For these and many other reasons, by the mid-1930s almost all private insurance carriers stopped covering the peril of flood in their standard home insurance product. In 1968, the NFIP was established to make affordable flood insurance available both to aid recovery and to require land use regulation by local governments that desired to make the program available to their residents and businesses. Today, there are just under five million flood policies with the NFIP, but Congress's goal never was to make the NFIP function just like a private insurer no matter that policyholders have come to expect it. The NFIP is $20 billion in debt, charges artificially low rates to over a million structures, and insures buildings that have flooded many times. Despite that, it is also the world's largest, most comprehensive, and most successful floodplain and flood mapping management program. It can rightly claim that the land use and building provisions of the program prevent nearly $2 billion of damage annually. Past reforms haven't been enough to keep up with the changing market and demand, and as Congress currently considers reauthorizing the program there is an opportunity to make those needed changes.

Society needs better coordinated consideration of the long-term impact of development coupled with much higher design standards for renovation/replacement of existing infrastructure, buildings, and other development. Building safely prior to devastation caused by foreseeable natural processes would be in stark contrast to our current practice of encouraging development that results in huge externalities. Some are permitted to place their true costs of development on others, resulting in huge expenditures of taxpayer funds, misery to those afflicted (especially traditionally underserved populations), and vast environmental devastation. Focusing only on the NFIP, a small part of a much larger problem, as not taking the long view of a system that is producing undesirable results cannot produce good public policy. Understanding both the potential and limitations of a reformed NFIP, as outlined in this article, is needed as part of a viable solution to the growing toll of flood-related disasters.

Mitigation

The NFIP is much more than a consumer-based program; instead the floodplain management component is its most critical piece, one that saves taxpayers $2 billion annually in avoided flood losses. Most flood losses happen to structures built before flood maps existed or built below published flood map elevations. Elevating these homes in turn would greatly reduce the number of flood losses annually. An elevated home means a lower insurance premium. Almost every NFIP policy has a small premium for separate coverage for increased cost of compliance (ICC), providing $30,000 to elevate, demolish, move, or flood-proof a significantly damaged building. ICC coverage is an obvious candidate for NFIP reforms to promote mitigation; $30,000 is not enough to elevate a home in today's dollars. ICC coverage for, say, $60,000 with the option to buy more could result in less reliance on post-disaster grant funding and a faster response to claims on the policy.

The NFIP estimates that it insures about one million buildings built before flood maps existed in the locality. Some estimates show over three million of these structures in high-risk flood areas that are not insured through the NFIP. Estimates to elevate all these structures approach $1 trillion. FEMA has made its goal to quadruple investment in mitigation over the next five years. Currently there are major problems in directing mitigation funds to where they are needed. Some grants are limited, nationally competitive, and subject to appropriation by Congress each year. Some grants are available only after a disaster, ignoring the better use for pre-disaster mitigation. Congress typically appropriates about $200 million to pre-disaster grant funding, compared to an estimated annual need of at least $1 billion. ICC, much like the other grant programs, also responds only after a loss. Congress has considered allowing a certain percentage of ICC to be used as a pre-disaster grant. Finally, available funds sometimes go unused. Instead, incentives such as loss-free credits on flood premiums could encourage property owners to mitigate to avoid flood losses on their own.

Mandatory Purchase

Property lenders in the United States require flood insurance if the lender is federally insured, supervised, or regulated and the property is in a high-risk flood zone. This is the "mandatory purchase" requirement. Many believe that mandatory purchase has failed, but the experiences after recent storms tend to show that mandatory purchase, as currently enforced, complies with federal law but is not a cost-effective substitute for post-disaster federal grants or other relief. Only 12% of American households have flood insurance, arguing for incentives for those not subject to mandatory purchase. The purchase of flood insurance has not become a cultural and social norm. Flooding can follow rain no matter what FEMA flood maps might predict, and the maps are developed to show a 1% chance of flooding per year at a given location—not a chance of a flood once every 100 years. Houston has experienced major "1%" floods for four consecutive years, and about 85% of Hurricane Harvey victims did not have flood insurance—it was not mandatory for them.

Current FEMA flood maps include a "shaded X zone" with a 0.2% chance of flooding, where mandatory purchase also could be required. Mandatory purchase could be expanded to all federally backed loans, not just those in high hazard areas. If the peril of flood were to be added to a routine, private homeowners insurance policy as an endorsement, coverage could be greatly extended. Flood insurance also could be "opt out" coverage rather than "opt in." Some argue for a national standard "all hazards" or universal catastrophe risk policy. The American Bar Association passed a comprehensive Resolution on disasters in 2009 that included such a suggestion.[3] Expanding mandatory purchase may be an easier route, since it has a current mechanism to expand on.

Private Involvement

For almost 50 years, the NFIP has been the sole insurer for most residential structures. Flood coverage was eliminated from private homeowners insurance due to the uncertainty of flood waters. It's very difficult to predict where water will accumulate and move and how many areas will flood and when. Technology now has developed such that today an underwriter can run over 100,000 models in five minutes that will begin to add certainty to loss ratios. As a result, the private flood insurance industry is growing at rates never before seen. Former FEMA Administrator Roy Wright instituted two "moon shot" initiatives to be the basis of all of FEMA's actions going forward. One is to double the number of persons with flood insurance, the other is to quadruple the amount available for mitigation by 2023. To help accomplish these goals, the NFIP has made two steps toward a transition between the NFIP and private flood policies. The NFIP now allows one to cancel its policies upon proof of purchase of a private policy. It also canceled a rule that insurers that sell federal flood policies may not directly sell private flood insurance as well.

Congress has addressed a disincentive to private flood insurance, namely, that one who cancels an NFIP policy with "grandfathered" coverage provisions or subsidized premiums thus loses access to same forever. The House of Representatives in 2016 passed the Market Parity Act, allowing the preservation of beneficial ratings in the NFIP so long as the insured replace the NFIP policy with a private policy. At this time, the industry also awaits action by lending regulators to issue final guidance on what provisions meet the mandatory purchase requirements or see that detail addressed in the Market Parity Act, which awaits action in the Senate. Lenders now are subject to a $2,000 fine per violation of the mandatory purchase requirement, thus the need for certainty.

NFIP reform could also include provisions for fair contributions by private insurers to NFIP costs for flood mapping and floodplain management administration, now charged to federal insurance policyholders as a $50 fee. The NFIP for its part is moving forward with new rating systems, policy changes, and additional optional coverages to keep abreast of private industry developments.

Affordability

NFIP flood insurance has seen annual premium increases up to 25%, plus fees, surcharges, and other costs. Some who argue that the NFIP is a burden on taxpayers point to the $20 billion debt and the vastly undercharged rates as justification for higher rates. Others suggest reforms to the NFIP that allow appropriate premium increases and reduce flood risk, while still helping to bring rates to full risk. Affordability can be in the form of mitigation assistance: as the most expensive premiums are charged to buildings not elevated, the policy choice is either to pay to elevate these buildings before the storm or pay to repair or replace them after a storm.

Some suggestions: An affordability framework should not include more cross-subsidies, such as a structure being charged a higher rate to give a discount to make another flood policy affordable. This type of affordability system is currently being proposed by Congress. It should include a robust mitigation investment program to target those structures that are subject to the most significant rate increases and offer cost assistance to elevate them. Premium increases should approach actuarial rates only gradually, say at 10% per interval, to help the NFIP retain policyholders and grow the program. Grandfathering as opposed to subsidized rates can be retained to reward those with the foresight to purchase flood insurance at the first instance. Some surcharges and fees for some second homes can be less unattractive. The fees on a preferred risk policy (purchased by those in low-risk zones) can increase the total cost by 50%, discouraging the optional purchase of flood insurance. The SAFE NFIP Act would impose surcharges for use as mitigation funds. The current NFIP debt should be forgiven. The program ran with no sustained debt until 2005, and Hurricane Katrina recovery, which in turn limited the funds available for recovery from Superstorm Sandy, then caused the program to continue to spiral into more debt. Finally, the NFIP's purchase of reinsurance should continue and expand.

Endnotes

1. ABA House of Delegates, Resolution 108 (Feb. 2017), https://www.americanbar.org/content/dam/aba/administrative/state_local_government/house/resolution-108.authcheckdam.pdf.

2. *See, e.g.*, Edward Thomas & Lincoln Walther, *Hazard Mitigation in Disaster Recovery*, *in* AM. PLANNING ASS'N, PLANNING FOR POST-DISASTER RECOVERY BRIEFING PAPERS (2014), https://www.planning.org/publications/document/9139480/.

3. *See Insurance and Mitigation*, A.B.A., https://www.americanbar.org/content/aba/groups/committees/disaster/policy/insurance_and_mitigation.html(last visited July 9, 2018).

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