OLR RESEARCH REPORT

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OLR BACKGROUNDER: NATIONAL FLOOD INSURANCE PROGRAM

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This report describes the National Flood Insurance Program (NFIP), focusing primarily on its provisions for residential structures. It is based in part on a Federal Emergency Management Agency (FEMA) website, www.floodsmart.gov, and a November 12, 2012 article on the program in the *New York Times.*

SUMMARY

The NFIP, established in 1968, provides insurance for property owners and renters in areas subject to flooding. FEMA administers the program, but the insurance is sold through nearly 90 private insurance companies. The insurance is mandatory for homeowners with a federally backed mortgage if they live in an area subject to flooding, among others.

Flood insurance covers buildings and their contents. The average annual flood insurance premium is currently about $615, but for homeowners in areas at higher risk of flooding, an annual policy can cost as much as $3,289 for a policy that covers both the building and its contents, depending on the level of coverage. Premiums can be lower in municipalities that participate in the Community Rating System (CRS), as eight Connecticut municipalities currently do.

The program was substantially in debt before Storm Sandy, and Congress recently authorized FEMA to increase premiums for second homes and properties that are repeatedly subject to flooding. It also made a number of other substantive changes to the program.

PROGRAM DESCRIPTION

Homeowner's insurance does not cover losses due to flooding. As a result, Congress created the NFIP to (1) mitigate future flood losses through community-enforced building and zoning ordinances and (2) give property owners access to affordable, federally-backed flood insurance protection. Flood insurance is available through insurers at FEMA-set rates. A FEMA website, http://www.floodsmart.gov/floodsmart/pages/choose_your_policy/agent_locator.jsp, allows property owners and renters to search for participating insurers serving their communities.

As part of the NFIP, FEMA identifies flood hazard areas throughout the United States, which are identified on flood insurance rate maps. The current flood maps for Connecticut are available online at www.fema.gov. Several areas of flood hazards are identified on these maps. One of these areas is the Special Flood Hazard Area (SFHA), which includes any land that would be inundated by a flood having a 1% chance of occurring in a given year. While these are often called 100-year floods, they actually occur more frequently; there is a 26% chance of flooding occurring in such areas during the term of a 30-year mortgage, according to FEMA.

Development may take place within these high-risk areas so long as it complies with local floodplain management ordinances, which must meet the minimum federal requirements.

When Insurance Is Required

Homes and other buildings in SHFA's with mortgages from federally regulated or insured lenders must have flood insurance. Buildings in moderate-to-low flood risk areas that have mortgages from federally regulated or insured lenders are typically not required to have flood insurance. But a lender can require flood insurance, even if it is not federally required.

When property owners receive financial assistance from the federal government following a presidentially-declared disaster (e.g., Storm Sandy), they may be required to purchase flood insurance. The requirement applies when a building in an area that is at high risk of flooding has been damaged. The coverage must be maintained even if the damaged building is replaced by a new one. If the property is sold, the seller must inform the new owners that they must maintain flood insurance coverage on the building. Renters who receive federal financial assistance must maintain flood insurance coverage on the contents of their units for as long as they live at the flood-damaged rental property. People who do not comply with the insurance requirements may become ineligible for federal financial assistance in the future.

FEMA updates flood maps periodically. Properties that are newly designated as being in high-risk areas must obtain flood insurance. Properties that meet certain loss history requirements may be eligible for reduced rates under the preferred risk policy program. Further information about this program is available at http://www.floodsmart.gov/floodsmart/pages/flooding_flood_risks/prp_extension_for_property_owners.jsp.

Coverage

Flood insurance covers buildings and their contents. Building coverage includes such things as:

1. the building and its foundation;
2. electrical, heating, air conditioning, and plumbing systems;
3. major appliances such as refrigerators and stoves; and
4. permanently installed carpeting over unfinished flooring.

Contents coverage includes such things as:

1. clothing, furniture, and electronic equipment;
2. curtains;
3. window air conditioners;
4. portable microwaves and dishwashers;
5. carpeting that is not included in building coverage; and
6. clothes washers and dryers.

The two common reimbursement methods for flood claims are replacement cost value and actual cash value. The former is the cost to replace damaged property. It is used for single-family, primary residences that are insured to within 80% of the building's replacement cost. All other buildings, as well as contents and other personal property, are valued at actual cash value. This is the replacement cash value of the property at the time of loss, minus physical depreciation.

Policies typically have a $2,000 deductible for the building and for its contents. Higher deductibles are available.

There is usually a 30-day waiting period for new policies. The waiting period does not apply in certain cases, as when insurance is being purchased in connection with the making, increasing, extending, or renewing of a loan on the property.

Premiums

For one- to four-unit residential buildings (including condominiums and townhomes) in high-risk areas, flood insurance premiums are calculated based on factors such as:

1. the year of the building was constructed;

2. building occupancy;

3. number of floors;

4. location of the building's contents;

5. flood risk (i.e., the building's flood zone);

6. the location of the lowest floor in relation to the elevation requirement on the flood map (in newer buildings only); and

7. the amount of building and contents coverage and the deductible.

Table 1 shows typical rates for residential properties in high-risk areas, assuming $2,000 deductibles for the building and for its contents. As discussed below, premiums can be lower in municipalities that participate in the Community Rating System (CRS) program.

Table 1: NFIP Premiums for Residential Properties in High Risk Zones

BUILDING & CONTENTS		BUILDING ONLY		CONTENTS ONLY	
Coverage	Annual Premium	Coverage	Annual Premium	Coverage	Annual Premium
$35,000/10,000	$472	$35,000	$376	$10,000	$136
50,000/15,000	634	50,000	490	15,000	184
75,000/20,000	874	75,000	682	20,000	232
100,000/30,000	1,183	100,000	874	30,000	349
125,000/40,000	1,514	125,000	1,067	40,000	487
150,000/50,000	1,844	150,000	1,259	50,000	625
250,000/100,000	3,289	250,000	2,014	100,000	1,315

Source: FEMA

Community Rating System

The CRS is a voluntary incentive program that encourages community floodplain management activities that exceed the minimum NFIP requirements. In participating communities, flood insurance premium rates are discounted to reflect the reduced flood risk resulting from the community actions. The three goals of the CRS are to:

1. reduce flood damage to insurable property,
2. strengthen and support the insurance aspects of the NFIP, and
3. encourage a comprehensive approach to floodplain management.

For participating communities, flood insurance premiums are discounted in nine increments of 5%; i.e., the maximum discount is 45%. Communities are ranked on 18 activities in four categories:

1. public information,
2. mapping and regulations,
3. flood damage reduction, and
4. flood preparedness.

Additional information about CRS is available at http://www.fema.gov/business/nfip/crs.shtm. According to this website, eight Connecticut municipalities currently participate in the system: East Lyme, Milford, Newtown, Norwalk, Stamford, Stonington, West Hartford, and Westport. Premium discounts in these municipalities range from 5% to 15%.

CURRENT STATUS AND ISSUES

Program Solvency

Although the NFIP is supposed to be self-funded, it fell $18 billion into debt after Hurricane Katrina and is at risk of running out of money as the reconstruction from Storm Sandy gets under way. An op-ed in the November 28, 2012, New York Times estimates that the storm could cost the program $7 billion and argues for phasing out the program.

Part of the existing shortfall in funding arises from the subsidizing of premiums for older properties. More than one million property owners who live in homes at least 40 years old have historically paid only about 40% of the actual cost of the coverage the program provides. An analysis of two decades of claims by the Wharton Risk Center at the University of Pennsylvania shows that certain states, like Texas, which has the second-largest number of flood insurance policies, pay much less in insurance premiums than the homeowners there collect in damage claims. The problem of repetitive claims is much less prevalent in the northeast.

Program Reauthorization

Earlier this year, Congress extended the NFIP until September 30, 2017 and amended it to allow large premium increases for certain property owners. The law phases in actuarial (cost-based) rates by increasing premiums 25% per year for certain second homes, flood-damaged properties that have received flood payments equal to or exceeding fair market value, business properties, and properties that have had severe repetitive losses. The law also:

1. prohibits FEMA from providing subsidized rates for new policies, for newly purchased properties, and certain other policies;

2. requires that the premium on existing policies be adjusted to reflect the current risk of flood in areas whose flood rating has been revised, with any increased rate phased in over 5 years at 20% per year;

3. establishes minimum annual deductibles ranging from $1,000 to $2,000, depending on when the building was constructed and its value; and

4. allows policyholders who are not required to escrow their premiums and fees for flood insurance to pay their premiums in installments.

The new law also requires (1) the Government Accountability Office to study the feasibility of adding business interruption and additional living expenses coverage to the NFIP and (2) the Federal Insurance Office to study and report to Congress on natural disaster insurance issues and possible legislative solutions.

PRINCIPAL WEBSITES CITED

Flood Insurance, Already Fragile, Faces New Stress, The New York Times, Nov. 12, 2012, http://www.nytimes.com/2012/11/13/nyregion/federal-flood-insurance-program-faces-new-stress.html?pagewanted=all&_r=1&, last visited Nov. 28, 2012.

NFIP website www.floodsmart.gov

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