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The Floodwaters of Reform: National Flood Insurance Program Changes to Begin April 1

On April 1, 2015, Congress will begin implementing changes to the National Flood Insurance Program (NFIP) as called for by the Biggert-Waters Flood Insurance Reform Act of 2012 and the Homeowner Flood Insurance Affordability Act of 2014. These reforms slow some flood insurance rate increases and offer relief to policyholders who experienced steep flood insurance premium increases in 2013 and early 2014. (For background information, see "Change is coming to the National Flood Insurance Program" and "The National Flood Insurance Program Homeowners Flood Insurance Affordability Act" in the July 2013 and June 2014 *VLCT News*, respectively.) Flood insurance rates and other changes will be revised for new and existing policies beginning on April 1, 2015.

Quick History. In 1968, Congress created the NFIP to allow property owners to insure against flood loss since most homeowners' insurance policies do not cover flood damage. Owners of buildings located in high risk areas called Special Flood Hazard Areas (SFHAs) built *before* a community received its first Flood Insurance Rate Map (so-called pre-FIRM structures) could obtain flood insurance at a subsidized rate that did not reflect the property's true risk of flooding. The NFIP was set up to be self-sustaining; but during episodes of higher than normal flood insurance claims, the program borrows money from the U.S. Treasury, which it theoretically pays back with interest. NFIP reform is driven mainly by the fact that by 2012, the NFIP was billions of dollars in debt.

The first move toward NFIP reform was the Biggert-Waters Flood Insurance Reform Act of 2012 (BW-12), which resolved to limit or eliminate subsidies for pre-FIRM structures so that premiums were at full risk rates. A full risk rating means that the premium is based on how high or low the lowest floor elevation is compared to the Base Flood Elevation.

When some homeowners saw flood insurance premiums increase by staggering amounts and the implications for such an impact became obvious, the outcry nationwide was enormous, especially in coastal areas and areas with older, subsidized housing stock. Nationwide, approximately 20 percent of NFIP policies are subsidized for pre-FIRM structures. Vermont communities enrolled in the NFIP received their first Flood Insurance Rate Maps in the 1970s. Notably, Vermont is one of the top five states with the highest percentage of currently subsidized pre-FIRM policies at over 50 percent. New requirements under BW-12 activated the full actuarial premium rate upon the sale of these pre-existing subsidized properties. Likewise, any new policy for a subsidized property or a lapsed policy would be reinstated at the full-risk rate. As expected, the significant rate increases resulted in a flood of opposition from many venues including unprepared property owners, realtors, and politicians.

Fast forward to the Homeowner Flood Insurance Affordability Act of 2014 (HFIAA), which was passed by Congress to address the outcry, at least temporarily, by implementing the rate changes more gradually and avoiding major adjustments in insurance costs at the time of sale. The HFIAA amends some of the changes made under the BW-12, but is in no way a wholesale repeal of the legislation. Under HFIAA, the goal of limiting subsidies is still very much present but the transition will be less dramatic overall. HFIAA also makes additional program changes for new and current flood insurance policy holders.

Highlights of the Federal Law Changes

Annual insurance rate change increases. For buildings in the flood hazard area, insurance rates will continue to rise, but the rate increases will be tempered. Flood insurance annual rate increases for primary, owner-occupied residences built before 1978 (i.e., pre-FIRM structures) will increase by not more than 18 percent, plus fees. Pre-

FIRM vacation, rental, and business properties will continue to go up by 25 percent per year until they reach the full-risk rate, the same increase mandated under BW-12. Pre-FIRM structures that have been substantially damaged or improved – that is, reconstructed at a cost that equals or exceeds 50 percent of the structure's market value before the improvement – will have an annual rate increase of 25 percent. (This represents a change from BW-12 that reclassified all substantially damaged buildings as post-FIRM and immediately required full-risk rates.) However, since repairs made to substantially damaged/improved structures should have met current flood hazard regulatory standards that enhance protection from future flood damage, sometimes the full-risk premium is lower than the subsidized premium and will be applied.

Reserve Fund Assessment Increasing. In 2013, as a requirement of BW-12, the Federal Emergency Management Agency (FEMA) began collecting a five percent assessment on all policies except for Preferred Risk Policies (PRPs), which are low cost flood insurance policies for residential structures located in areas of low to moderate flood risk. The Reserve Fund was established to help fund costs when insurance claims exceed the annual premium. In 2015, this fund will increase to 15 percent for all policies except PRPs, which will be assessed at 10 percent.

Surcharges of $25 or $250. Starting April 1, an annual surcharge will be added to all flood insurance policies: $25 to primary residential structures and $250 to non-primary residential and non-residential structures. The surcharge also applies to a renter's contents-only policy. These surcharges will be collected until all subsidies are eliminated. According to the Strategic Alliance for Risk Reduction (STARR, a FEMA technical service contractor), FEMA does not have reliable documentation of whether residential structures are primary or non-primary. All residential structures are being treated as non-primary, until the structure is determined to be a primary residence. Insurance companies should have sent letters to their policy holders over the last few months informing them of the surcharge and the documentation required, although it is unknown how many of those letters were overlooked or ignored. How many primary residential policy owners will be surprised with a $250 surcharge because they didn't provide documentation is yet to be seen.

Maximum Deductible. Another notable change in the NFIP is a newly created maximum deductible up to $10,000 for single family and two-to-four family dwellings to help make some policies more affordable. If this higher deductible is used, it must apply to both the building and the building contents. According to an October 2014 FEMA fact sheet, choosing the maximum deductible will result in up to a 40 percent discount from the base premium, but there is no guarantee that mortgage companies and other lenders will accept this higher deductible.

When a Map Change Occurs. The NFIP allows "grandfathered rates" for eligible property owners of structures built in compliance with a prior flood rate map after a new one has been released. These grandfathered rates, which were to be phased out under BW-12, were restored in part by HFIAA. Under the grandfathering provision in the HFIAA, the *first year premium* for properties newly identified in the flood hazard area would be charged a very favorable flood insurance premium rate equivalent to a property not located in the regulated floodplain (a PRP). From this baseline, flood insurance premiums are phased into full-risk rates through premium increases not to exceed the maximum cap of 18 percent per year.

FEMA is scheduled to release a map change for Bennington County later this year. According to Ned Swanberg, Flood Hazard Mapping Coordinator of the Vermont Department of Environmental Conservation, when that map change happens, 458 structures will be identified as being in the high risk Special Flood Hazard Area for the first time. "The new act (HFIAA) allows people in Bennington County to benefit by getting flood insurance before the upcoming map change," says Swanberg. "If a building will be officially recognized to be in a higher flood risk zone, it is possible to get flood insurance before the change for the old and lower cost zone and to 'grandfather' that zone at the lower cost." The preliminary Digital Flood Insurance Rate Map for Bennington County can be viewed on the Flood Ready Atlas at tinyurl.com/floodreadyatlas. There will be community meetings in Bennington County to discuss flood insurance opportunities later this year.

For more information, FEMA summarizes the changes in its October 2014 Fact Sheet, How April 2015 Program Changes Will Affect Flood Insurance Premiums, which is posted on its website, http://www.fema.gov/. An explanatory video is at www.fema.gov/media-library/assets/videos/84716.

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