Making the NFIP Work for Taxpayers and Policy Holders:
Policy Affordability and Program Stability
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Policy Affordability and Program Stability

Introduction
The Biggert Waters Flood Insurance Reform Act became federal law on July 6, 2012.1 U.S. Rep. Judy Biggert (R-IL), one of the law’s eponymous authors, told colleagues, “Today’s flood reform measure demonstrates a true, democratic process, where reforms are publically vetted, reflect input from interested stakeholders, and are realized.”2

As the Biggert Waters Act was implemented, angry, frustrated, and confused consumers inundated Congress with complaints of exorbitant increases in flood insurance premiums. On March 4, 2014, the U.S. House of Representatives approved the Homeowner Flood Insurance Affordability Act (HFIAA), by a vote of 306 – 91. On March 13, the U.S. Senate overwhelmingly supported HFIAA by a vote of 72 – 22, sending the measure to President Obama who signed HFIAA on March 21, 2014.3

The Biggert Waters Act accelerated flood insurance premium increases to quickly achieve actuarial rates with the goal of stabilizing the National Flood Insurance Program (NFIP) and building program income and reserves.4 By rapidly increasing premiums, the Act caused substantial disruption in household finances and impaired a recovering housing market.5 Less than two years after Congress set in motion substantial increases in flood insurance premiums legislators reasserted the long-held view that premium affordability is a fundamental tenet of national flood insurance.

HFIAA Addresses Structural Problems with Biggert Waters Act Implementation
While HFIAA was a direct reaction by federal policymakers to consumer complaints over premium increases, the Act also addressed programmatic concerns exposed through the implementation of the Biggert Waters Act. Additionally, many policymakers sought to combine these structural reforms with policies to create market space for private carriers to write flood insurance coverage. House Majority Whip Steve Scalise (R-LA) summed up the views of many in Congress when he said during debate on HFIAA in the House of Representatives—

“So what we are bringing to the floor today is an actual solution to a problem. This is not some delay. It is a real, long-term solution that pays for itself within the program with real reforms that allow people to move forward with a flood insurance program that will be sustainable and ultimately lead to a private market where you don’t just have FEMA to go to, you can actually have private options as well for families.”6

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1 P.L. 112-141, Section 100201, et seq.
3 113th Congress: U.S. House of Representatives roll call vote no. 91; U.S. Senate Record Vote 78; P.L. 113-89.
5 In congressional testimony on behalf of the National Association of Realtors, Mr. David McKey described the impact of Biggert Waters Act implementation, saying “News reports of surprise “$30,000 flood insurance” notices drove buyers away from properties located in the floodplain and had a chilling effect on real estate markets everywhere.” See Hearing Entitled “No More Hikes: Small Business Survival Amidst Unaffordable Flood Insurance Rate Increases”, U.S. Senate Small Business Committee: June 30, 2016.
The Act required changes to the Federal Emergency Management Agency’s (FEMA) flood mapping program to improve map accuracy. HFIAA provided significant new consumer protections including the establishment of the Flood Insurance Advocate, increased funding for consumers who successfully appeal flood maps, and halted the imposition of full risk premiums for policies on certain properties that had been improved or sold. These and other long-term policy solutions benefit communities and consumers while providing a level of program stability for NFIP.

The HFIAA Premium Adjustment
Under the Biggert-Waters Act, Congress sought to eliminate premium subsidies from NFIP by charging policyholders located in higher flood risk areas elevation-based rates reflective of the insured structure’s location on a current Flood Insurance Rate Map (FIRM). This programmatic change had a substantial negative effect on policy affordability for policyholders where—

- insured structures had been constructed prior to the issuance of a FIRM;
- insured structures were built in compliance with the FIRM effective at time of construction, but were subsequently mapped into a higher flood risk area;
- policyholders had maintained continuous flood insurance coverage;
- an insured structure was sold after the effective date of the Biggert Waters Act; or,
- damages or improvements equaled or exceeded 30 percent of the structure’s fair market value.

In HFIAA, policymakers addressed premium affordability concerns by restoring the practice of rate “grandfathering”, reversing the elimination of pre-FIRM subsidized (PFS) policies, eliminating the property sales trigger, and increasing damage and improvement thresholds. According to estimates, approximately 20 percent of NFIP policies are classified as PFS. Additionally, FEMA estimates 10 percent of NFIP policyholders pay rates based on the flood rate map in force at the time of the insured structure’s construction or initial rating at the time continuous coverage was purchased.

To provide Biggert Waters Act rate relief for homeowners, Congress reset NFIP rates to pre-Biggert Waters Act levels, but included a minimum annual average increase of 5 percent for PFS rate classifications. This HFIAA mandate remains in place until rates meet actuarial standards as NFIP premiums may not, by law, exceed the full chargeable risk rate. HFIAA also reset rates for

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7 NFIP has established two broad property classifications to denote properties constructed prior to an area being mapped for flood risk and those properties constructed or substantially improved in areas that have been mapped for flood risk. Pre-Flood Insurance Rate Map or pre-FIRM properties may be eligible for flood insurance where premiums do not reflect the insured structure’s full flood risk. In this paper such policies are referred to as pre-FIRM subsidized (PFS) policies. Flood insurance policies covering post-FIRM structures are generally to be charged full risk rates. Certain post-FIRM properties may be eligible for “rate grandfathering” if there is satisfactory evidence of compliance with the FIRM in force at time of construction and policyholders have maintained continuous NFIP coverage (includes pre-FIRM properties). Under rate grandfathering, premiums are based on zone and elevation (if known) at time of construction or initial policy purchase notwithstanding an increase in flood risk as determined by a subsequent FIRM.

8 National Academy of Sciences, Affordability of National Flood Insurance Program Premiums, Report 1, Chapter 3 (2015): p. 14 notes that approximately 20 percent of all NFIP policies are classified as pre-FIRM subsidized (approximately 1 million policies). Page 74 of the NAS report indicates that internally, FEMA estimates 10 percent of policies pay grandfathered rates.

9 42 U.S.C § 4015(e)(2) and 42 U.S.C. § 4014(a)(1)
grandfathered policies, but in general did not subject these policies to minimum annual premium increases.

HFIAA rate relief also included limits on annual premium increases in most risk categories. Under the Act, average premiums within a risk classification may not increase by more than 15 percent annually and no individual policy premium may be increased by more than 18 percent annually.\textsuperscript{10}

While the HFIAA affordability provisions had an immediate positive impact for subsidized policyholders and policyholders eligible for rate grandfathering, prompt elimination of subsidies for other rate classes was retained. Premium subsidies on policies covering business properties, investment properties, severe repetitive loss properties, and properties with damages or improvements equal to or greater than 50 percent of the insured structure’s fair market value must by law increase 25 percent per year until actuarial rates are achieved.

Then Rep. Bill Cassidy noted the eventuality of higher flood insurance premiums for all rate classifications, saying rate reform in HFIAA, “...puts the program on a glide path to actuarial soundness and, in the meantime, benefits Americans across the way.”\textsuperscript{11} The “glide path” mentioned by Rep. Cassidy was a key affordability reform of HFIAA, in that the velocity of rate increases for policies covering primary residences was greatly reduced and mandatory timelines to achieve actuarial rates for most residential subsidized policies were removed. These changes to the Biggert Waters Act provided a reprieve for households from what Rep. Scalise termed “a death sentence” to be carried out through immediate, unsustainable premium increases.\textsuperscript{12}

Notwithstanding this reprieve, policyholders will continue to absorb year-over-year premium increases with certain subsidized risk classifications exposed to continuous increases until premiums reach a rate NFIP determines to be actuarially based.\textsuperscript{13} The key affordability variable for such policyholders is the annual rate increase decision taken by NFIP.\textsuperscript{14} If NFIP sets rates at the higher limits of HFIAA permissible levels on a year-over-year basis, affordability will rapidly become a substantial concern for millions of NFIP policyholders.

The affordability risk is not a theoretical question. Policyholders whose properties are not eligible for HFIAA rate relief—business properties, investment properties, and second homes—face 25 percent

\textsuperscript{10} 42 U.S.C 4015(e)(3); note that annual rate increase limitations do not apply to business properties, severe repetitive loss properties, and second homes, which are subject to alternative pricing requirements.


\textsuperscript{12} Congression Record, March 4, 2014: p. H2137.

\textsuperscript{13} In 2015, the National Academy of Sciences noted that current NFIP rates are based on average risk of flood loss posed by a group of properties rather than based on an individual property’s risk of flood. All properties within a single risk grouping are charged the same base rate. For a full discussion of actuarial pricing in the NFIP and certain violations of actuarial principles in setting premiums for full-risk rate policies, see National Academy of Sciences, Affordability of National Flood Insurance Program Premiums, Report 1, Chapter 3 (2015). Additionally, in 2009, the Congressional Budget Office concluded it “...cannot determine whether the full-risk premiums currently used in the flood insurance program are actuarially adequate on the whole.” Congressional Budget Office, The National Flood Insurance Program: Factors Affecting Actuarial Soundness (November 2009), p. 13.

\textsuperscript{14} Excluding rate classifications with a statutory requirement that rates be increased on a specified schedule.
year-over-year premium increases. Some have forecast that at this rate of annual premium increases, such properties will soon be priced out of NFIP coverage.\textsuperscript{15}

\textit{Design Post-Biggert Waters Act NFIP for Consumers}

In the 2017 NFIP reauthorization policymakers must adopt a stronger policy framework addressing premium affordability that recognizes the economic, cultural, defense, and other national contributions made by communities exposed to flood risk. Policymakers must emphasize collaboration with local and state governments to identify, model, and take effective action to mitigate flood risk. A comprehensive approach to reduce flood losses before a disaster occurs is a more effective means to avoid economic loss and protect taxpayer interests than expelling individual households and businesses from NFIP through unsustainable and unaffordable flood insurance premiums.

Sustainability and affordability of flood insurance coverage is a growing concern as NFIP is experiencing a year-over-year decline in several key metrics. According to FEMA data, NFIP policies-in-force peaked in 2009 at 5,700,235. As of June 30, 2016, the number of policies-in-force was 5,083,071, a decline of almost 11 percent from 2009.\textsuperscript{16} Total coverage-in-force is also in decline after peaking at approximately $1.3 trillion in 2013 and as of June 30, 2016, is approximately $1.25 trillion. For only the second time since 1978, total premium earned has fallen from the previous year, with $3.54 billion of premium earned in 2014 compared to $3.44 billion in 2015.\textsuperscript{17}

This is not sufficient evidence to validate a long-term forecast of year-over-year decline for NFIP, but policymakers must be mindful of data showing declines in core program variables over the short-term. It must also be noted that key coverage-in-force and premium earned declines have largely occurred post-Biggert Waters Act.

It is in the national interest to ensure workforce housing and services in the communities that are hubs of domestic energy production, international trade, national and international finance, agriculture and aquaculture production, and other nationally-significant economic and defense activities. Affordable and sustainable flood insurance is an integral component of ensuring these communities continue their vital contributions to the nation.

For policymakers to more fully achieve the core purposes of national flood insurance—floodplain management, limiting government disaster costs, and facilitating property owner purchase of insurance—the NFIP must be designed with the interests of end users as preeminent. Taxpayer and program partner interests are better served by increasing total premium income earned by NFIP. Increases in both policies written and coverage in force will bring greater stability to communities and provide greater protection for the federal fisc. To achieve this end, policymakers must ensure that flood

\textsuperscript{15} The authors of this paper are not alone in this concern. In previously referenced testimony (see footnote 5) before the U.S. Small Business Committee, Mr. David McKey, appearing on behalf of the National Association of Realtors, noted “If FEMA takes a typical pre-FIRM property and projects 25 percent increases compounded into the future, it would only take a few years before NFIP rates return to levels that led to the public outcry after BW12.” Testimony available at www.sbc.senate.gov.
\textsuperscript{16} https://www.fema.gov/policies-force-month (accessed October 4, 2016); author’s calculations
\textsuperscript{17} https://www.fema.gov/policy-claim-statistics-flood-insurance (accessed October 4, 2016).
insurance products offered through NFIP are expressly designed to meet the needs of consumers, are affordable, and delivered in ways that appeal to consumers.

Policy Proposals for a post-Biggert Waters Act NFIP
The 2017 NFIP reauthorization must build on HFIAA as a transition point to a sustainable flood insurance program that is relevant to the end user, the customer. To achieve this goal, Congress should adopt policies concerning—

» Reducing Subsidies While Protecting Policy Affordability
» Increasing Consumer Participation in NFIP
» Working with Private Capital to Increase Flood Insurance Coverage
» Aligning Flood Insurance Rates with Individual Property Risk
» The Consumer and Taxpayer Experience with the WYO Program
» NFIP Affordability and Protecting Communities through Flood Risk Mitigation

Reducing Subsidies While Protecting Policy Affordability
In HFIAA Congress revised key policies driving substantial increases in flood insurance premiums yet retained the Biggert Waters Act imperative to reduce or eliminate certain premium subsidies. In general, HFIAA limits year-over-year premium increases to 18 percent for individual insureds and 15 percent for the average of all premium increases within a risk classification. Premiums for most subsidized policies must, by law, increase at least 5 percent on an annual basis, subject to the overall limitation that NFIP not charge rates greater than a classification’s determined risk. Further, certain property classifications will see premium increases designed to rapidly eliminate subsidies.

HFIAA One Percent of Coverage Premium Limitation
HFIAA limits on annual rate increases do not fully address the underlying issue of premium affordability important to consumers, but do serve as a temporary check on the trajectory of premium increases. It is clear Congress understood the eventuality that even under HFIAA flood insurance premiums could again rise to unsustainable levels for a substantial percentage of NFIP policyholders.

To account for the inevitable increase in premiums for both PFS policies and policies written for post-FIRM insureds, Congress created an affordability standard that factors annual flood insurance premiums as a function of a policy’s total coverage amount. The statute reads, in pertinent part—

“In setting premium risk rates, in addition to striving to achieve the objectives of this chapter the Administrator shall also strive to minimize the number of policies with annual premiums that exceed one percent of the total coverage provided by the policy.”18

18 42 U.S.C. § 4015(j)
To illustrate, under this affordability mechanism NFIP must avoid instances where a policyholder whose policy coverage equals $100,000 pays annual premium in excess of $1,000. To ensure compliance with this congressional directive, FEMA is required to report to Congress on the number of policies where the premium for flood insurance exceeds one percent of the policy’s value.

FEMA submitted its first report to Congress concerning the one percent of coverage target premium on September 20, 2016. In the report, FEMA identified 428,317 policyholders, or 8.4 percent of all policyholders, as paying premiums in excess of the one percent standard. Additionally, FEMA reported that when non-premium policy fees are included, 701,483 policyholders, or 13.7 percent of the NFIP customer base, pay total policy costs greater than one percent of the coverage amount.\(^{19}\)

Disturbingly, in its report FEMA alleges it lacks statutory authority to act on the clear congressional directive to “strive” to minimize the number of policies that violate the one percent of premium standard. While certain policy classes were explicitly exposed to rapid premium increases, the clear intent of Congress was to reduce flood insurance premiums for the vast majority of policyholders within NFIP. In justifying its disregard of congressional intent, FEMA stated—

“Although HFIAA-14 instructs FEMA to strive to minimize the number of policies in this category, FEMA does not have the authority to adjust premiums based on an affordability threshold such as premium as a percent of coverage...FEMA was given authority to rate other properties, referred to as “subsidized” properties, less than full risk, but the rate levels are prescribed by legislation.”\(^{20}\)

FEMA’s conclusion the agency lacks authority to act on a clear and precise congressional directive follows a pattern of the agency implementing premium increases while disregarding the affordability needs of consumers. Congress purposefully included the one percent directive in 42 U.S.C. § 4015, which governs NFIP rate setting authority and as such intended the directive as a clarification of rate setting authority. Such an overt rejection of clear congressional intent, in legislation entitled the Homeowner Flood Insurance Affordability Act no less, is demonstrative of an agency culture that has strongly resisted premium affordability initiatives.

FEMA’s resistance to considerations of NFIP affordability for millions of homeowners who rely on NFIP policies dates back to the agency’s refusals to complete a congressionally-mandated affordability study in the Biggert Waters Act. In this instance, agency officials disregarded the plain language of the Act requiring FEMA to complete an affordability study, alleging that funding was insufficient.\(^{21}\) In HFIAA,


\(^{21}\) House Financial Services Committee, Report No. 113-52, *Implementation of the Biggert-Waters Flood Insurance Act of 2012: Protecting Taxpayers and Homeowners* (Washington, D.C., November 19, 2013). In a colloquy between U.S. Rep. Maxine Waters and FEMA Administrator Craig Fugate, Rep. Waters sharply questioned Administrator Fugate on FEMA’s implementation of premium increases while allowing the mandated affordability study to languish. Administrator Fugate stated that “they [NAS] informed us that the amount of funds and the timeframes would be insufficient, and they would only be able to begin part of that study.” Rep. Waters responded by asking “Did you come back to this committee to ask for some help with that...But you didn’t come back here and tell us any of what you are telling us now. Why didn’t you do that?”
Congress was more explicit with its affordability study requirement and FEMA complied, releasing the first of two affordability reports in March 2015.\(^\text{22}\)

FEMA must acknowledge that flood insurance affordability is a key component of NFIP, household, and community stability—not a secondary concern to be addressed at some future point. Flood insurance affordability must be the basis of NFIP reform.

This necessitates a change of culture within the agency at the highest levels of leadership. The need for a culture of affordability is effectively demonstrated in FEMA’s report on compliance with the one percent affordability standard. FEMA acknowledges in its report that as NFIP premiums increase, policyholders are opting against renewal. This outcome achieves an apparent FEMA goal of de-risking NFIP’s portfolio, but it does so by excluding homeowners from NFIP. A policy intended to price consumers out of NFIP places greater obstacles to community recovery in the event of flood losses resulting from a presidentially-declared natural disaster.\(^\text{23}\) FEMA wrote,

> “Premium increases apply both upward and downward pressure on the number of policyholders paying premiums in excess of 1 percent...Looking forward, as pre-FIRM subsidies continue to be phased out more policyholders will see premiums increase to levels above 1 percent of coverage. But many of these policyholders may drop flood insurance rather than pay higher premiums.”\(^\text{24}\)

It was precisely for this reason Congress enacted HFIAA, repealing unaffordable Biggert Waters Act premium increases and directing NFIP to strive to reduce the number of policies with premiums greater than one percent of coverage. This congressionally-mandated approach to premium affordability serves two important policy purposes. The economic value of flood insurance is retained for consumers and maximum policy increases are aligned with congressional expectations within the context of the Biggert Waters Act. The one percent of coverage standard was intentional and FEMA has a duty under law to adhere to it.

**Protecting the Economic Value of the Policy for the Consumer**

If a consumer does not believe flood insurance premiums are reasonably related to flood risk or the cost of potential flood damage, the consumer will not likely see value in maintaining an existing level of coverage. This is particularly so for policies with subsidized flood insurance rates.

In 2015, the National Academy of Sciences (NAS) noted the price elasticity of demand for flood insurance is significant where a consumer is in a higher-rate, or subsidized, environment. While

\(^{22}\) P.L. 113-89, Section 16

\(^{23}\) In many cases, federal disaster assistance is contingent on the purchase of flood insurance and may result in the denial of repair assistance through FEMA’s Individuals and Households Assistance program and the denial of low-interest disaster recovery loans through the Small Business Administration.

seemingly counterintuitive, subsidized policyholders, on average, pay higher premiums than unsubsidized policy holders. NAS wrote—

“Subsidized policy-holders may be much more responsive to changes in marginal price than those with full risk premiums (Landry and Jahan-Parvar, 2008).”

The HFIAA directive on the proportion of annual premium paid to total policy coverage reflects the Landry and Jahan-Parvar research. According to Landry and Jahan-Parvar the elasticity of demand for subsidized policyholders in a high rate environment was -2.09 percent for every 1 percent increase in premium. Landry and Jahan-Parvar concluded—

“Properties that face subsidized rates purchase significantly more coverage (on average, about $43,000, all else being equal), and are more sensitive to price, \( \varepsilon_p = -2.09 \). A 1\% increase in price leads to an approximate 2\% decrease in coverage demand for subsidized parcels.”

The HFIAA one percent of policy coverage limitation on premium addresses important factors in a consumer’s decision to purchase and maintain flood insurance coverage in higher risk areas. Additionally, the link to consumer economic decision-making is preserved by encouraging higher risk properties to maintain higher amounts of coverage, which FEMA acknowledges can impact the ratio of premium to coverage. Landry and Jahan-Parvar noted that properties with subsidized flood insurance rates tend to purchase more coverage than non-subsidized policies.

Aligns Maximum Premiums with Congressional Intent
Biggert Waters Act implementation severely damaged the reputation of the NFIP. Property owners and communities were exposed to financial shocks that upended household economics and community stability. The reputational damage was so severe that some homeowners protested by collecting house keys to send to federal policymakers to show the imminent threat of foreclosure due to unaffordable flood insurance premiums and loss of equity in homes.

Biggert Waters Act premium increases surprised policymakers. During debate on HFIAA in the House of Representatives, Rep. Shelly Moore Capito said—

“There was near unanimous agreement that significant reforms were needed for the program, but when the new flood insurance rates were published last fall, I began to hear from, and met with, many West Virginians who were shocked by the increases in their flood insurance bills that had far exceeded the worst-case scenario in CBO’s

27 Federal Emergency Management Agency, NFIP Policy Premiums Report: Homeowner Flood Insurance Affordability Act of 2014, p. 5. FEMA notes that due to front-loading of rates, the first $60,000 of basic coverage is more expensive than additional coverage over this threshold.
28 Landry, Craig and Mohammed Jahan-Parvar.
projection. In some cases, their only choice was to spend their life’s savings on their flood insurance bills or walk away from their house, ruining their credit.\(^{30}\)

Policymakers had relied on projections from FEMA, subsequently cited by other agencies such as the Congressional Budget Office (CBO), indicating policyholders with subsidized premiums paid approximately 40 to 45 percent of the actuarially-based premium.\(^{31}\) Congressional testimony by the Government Accountability Office (GAO) in 2011 is representative of the common expectation of policymakers in the context of Biggert Waters Act premium increases for subsidized policyholders—

“For example, the projected average annual subsidized premium was $1,121 as of October 2010, discounted from the $2,500 to $2,800 that FEMA said would be required to cover the full risk of loss.”\(^{32}\)

This explains why so many federal policymakers were shocked that under the Biggert Waters Act property owners were quoted flood insurance premiums well in excess of projections based on FEMA data.

The directive in HFIAA to limit the number of policyholders with premiums exceeding one percent of policy value ensures premium increases remain within the upper limits anticipated by Congress when the Biggert Waters Act was enacted. Take, for example—

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<tr>
<td>Total Insurance in Force June 2016</td>
<td>$1,245,739,480,000.00</td>
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<tr>
<td>Total Policies in Force June 2016</td>
<td>5,083,071</td>
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<tr>
<td>Average Coverage Per Policy</td>
<td>$245,076.00</td>
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Source: FEMA data and author’s calculations\(^{33}\)

According to FEMA data, the current average coverage in force for NFIP policies as of June 30, 2016, is $245,076. The HFIAA one percent of coverage limitation will, on average, limit annual flood insurance premiums to approximately $2,450. Such an outcome is clearly aligned with FEMA actuarial premium forecasts of $2,500 to $2,800 on which policymakers relied in 2012 when voting to phase out premium subsidies in NFIP.

Had Congress originally required FEMA to implement the Biggert Waters Act on the basis of the agency’s actuarial premium projections, homeowners and business owners would not have received rate quotes and renewal notices with premiums that did not, according to these consumers, relate to the value of


the property to be insured. In HFIAA, Congress took the deliberate decision to protect policyholders from severe rate and premium escalation by directing FEMA to avoid premiums that exceed the one percent of coverage threshold. Fundamentally, HFIAA’s one percent limitation implements the very policy Members of Congress believed had been achieved in the Biggert Waters Act.

**Affordability Incentives for Policyholders Exceeding One Percent of Coverage Premium Cap**

To ensure NFIP access and affordability in an upward rate environment, policymakers must retain incentives for policyholders to maintain continuous flood insurance coverage. Incentives must be designed with the consumer in mind and minimize the burden on consumers to receive affordability assistance.

Under current law and regulation, policyholders are not required to take any other action than to purchase and maintain flood insurance to benefit from premium subsidies as premium assistance is factored into the underlying financial transaction. In the case of grandfathered policies, continuous coverage is the key to policy affordability for consumers, including those with PFS policies.

This approach is not intended to direct subsidies to policyholders in a specific income range, but rather to achieve the long-standing public policy of encouraging homeowners to purchase and maintain continuous flood insurance coverage. This approach should be maintained and maximized.

Other than ensuring policies are affordable, rate grandfathering incentivizes policyholders to purchase additional coverage. While premium income may not be fully sufficient to offset total risk, it is better for taxpayers and communities to pre-fund flood disaster costs to the greatest extent possible through the purchase of flood insurance. Access to flood insurance claims payments allows homeowners and businesses to begin rebuilding sooner, signaling to neighbors and the community-at-large that homes will not be abandoned, but will be repaired and rebuilt, often subject to higher floodplain standards. For certain homeowners and businesses, flood insurance is a prerequisite for other forms of federal disaster assistance that may prove to be the difference between recovery and bankruptcy.

Creating a complicated means-tested program to retain the benefits of rate grandfathering and other program rate subsidies will likely reduce NFIP purchases as the need for flood insurance crosses many demographics, with households of varying incomes relying on grandfathered or other subsidized policies. Landry and Jahan-Parvar have noted increases in premiums for subsidized policies will result in the purchase of lower amounts of coverage or fewer policies, a conclusion validated by FEMA reports and data. This exposes taxpayers to disaster costs that may have otherwise been offset by flood insurance premiums.

The Biggert Waters Act and HFIAA both reflect the desire of policymakers to decrease subsidies within the NFIP as well as the bedrock principle that premium affordability directly affects consumer participation and consumer household stability. A new and burdensome process to deliver a subsidy that currently requires little action other than the purchase and maintenance of flood insurance
coverage will create confusion for consumers, limit consumer access to assistance, and likely increase costs for program partners.

Recommendations:

1) *Congress must retain—and FEMA must implement—the maximum premium target of one percent of policy value to ensure broad access to flood insurance coverage for consumers and to ensure NFIP premiums remain within target ranges meeting congressional expectations and statutory guidance.*

2) *FEMA must continue to identify and disclose policies that exceed the one percent of coverage affordability standard by disclosing the location and numbers of such policies by parish or county and state.* To ensure continued purchase of flood insurance in higher flood risk areas, federal policymakers must identify policyholders with premiums in excess of the one percent of coverage limitation. These policyholders are at greater risk of reducing coverage amounts, dropping coverage at renewal, or refusing to purchase flood insurance when exempted from mandatory purchase requirements. There is a clear federal interest in retaining program participation to offset future federal disaster costs through premium collection.

3) *For policyholders where premiums exceed one percent of coverage, limit future premium increases to no more than [100] percent of premium charged under the [2016] rate tables or the chargeable full risk rate, whichever is less.* Under this policy, a consumer with current annual premium costs of $1000.00 would have a maximum premium of [$2,000.00] unless the actuarial rate is determined to be less. Alternately, a policyholder with a current annual premium of $2,500.00 would have a maximum premium of [$5,000.00] unless the actuarial rate is determined to be less.

4) *Provide discounts for policyholders subject to the one percent of coverage premium limitation to ensure flood insurance policy costs do not cause total monthly mortgage related obligations to exceed [40] percent of monthly income with greater discounts provided as the ratio increases.* Federal housing affordability standards are typically based on the percentage of housing-related costs to a consumer’s monthly income. This is reflected in mortgage underwriting standards of the Federal Housing Administration and other housing-related government sponsored enterprises.

Borrowers whose mortgage-related obligations exceed 28 to 31 percent of monthly income may still be deemed to have sustainable housing costs if other factors such as short term debt, financial reserves, and credit score are taken into account. This process is not uniformly well-suited for NFIP policyholders, but a general affordability standard that ensures flood insurance costs do not cause a policyholder’s housing costs to exceed [40] percent of monthly income protects all households from excessive flood insurance premiums. Households with income below certain percentages of area median income will require additional assistance.

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34 The Federal Housing Administration permits a ratio range of total monthly mortgage obligations to monthly income of 31 percent to 40 percent, dependent on a borrower’s existing debts, credit score, financial reserves, and the likelihood housing related costs will increase. See HUD Handbook 4000.1, FHA Single Family Housing Policy Handbook, Part II.A.5.d.vii—Approvable Ratio Requirements (Manual).
5) **Limit premium assistance to mandatory purchase policyholders not required by a mortgage lender to purchase additional coverage through private carriers.** Such a limitation focuses premium assistance to households with mortgage debt of $250,000.00 or less. Policymakers should consider a higher limitation for homeowners in areas designated as having high housing cost.

6) **Permit certain negatively elevated structures to qualify for CRS discounts.** For policyholders exceeding the premium limiter of one percent of insurance-in-force and where total monthly mortgage related obligations exceed [40] percent of monthly income, permit the policy to receive CRS discounts even if the structure is determined to have a negative elevation.

**Rate Certainty for Policyholders**

In 2014, GAO modeled rate scenarios to necessary to achieve actuarial premiums for subsidized policies where an insured structure was at base flood elevation (BFE). GAO estimated it will take approximately 25 years to achieve actuarial rates on a subsidized $50,000 policy where the structure is at BFE if premiums are increased 5 percent annually. If, under this scenario, the insured structure is at -2 BFE, more than 30 years of 5 percent year-over-year increases are required to reach an actuarial rate.

GAO modeling also shows that higher year-over-year premium increases substantially reduce timelines necessary to achieve actuarial rates. According to GAO, if subsidized rates are subject to 15 percent year-over-year increases, the subsidy on $50,000 of coverage will be removed in almost 7 years. Where $250,000 of coverage has been purchased for a structure at -2 BFE and premiums are increased 15 percent year-over-year, GAO projects subsidies will have been removed in approximately 8 years.  

GAO’s rate scenarios examine increases only in policy premiums. Consumers pay a number of additional charges when purchasing flood insurance that have a significant impact on aggregate policy cost. Premium components of a typical NFIP policy include the base coverage premium (structure and contents), additional coverage premium (structure and contents), and Increased Cost of Compliance (ICC) premium. Additional policy fees include the Reserve Fund Assessment (RFA), which is calculated at 15 percent of premium, the HFIAA surcharge of $25 for primary residences and $250 for other properties, and the Federal Policy Fee (FPF), which varies by policy.  

According to FEMA rate bulletins, chargeable rates across the majority of risk classes increased in both 2015 and 2016. Table 1 shows 2015 and 2016 rate and policy cost increases across several rate classes.

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<tr>
<th>Zone Description</th>
<th>2015 (Δ rate)</th>
<th>2015 (Δ total)</th>
<th>2016 (Δ rate)</th>
<th>2016 (Δ total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PFS (AE &amp; VE) PR</td>
<td>14%</td>
<td>15%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>PFS (AE &amp; VE) NPR</td>
<td>24%</td>
<td>37%</td>
<td>24%</td>
<td>21%</td>
</tr>
</tbody>
</table>

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36 FEMA’s published fee schedule for 2016 sets the FPF at $25 for preferred risk policies and $50 for standard risk and subsidized policies, with additional charges for condominium projects based on number of units.
The range of rate increases and total policy cost increases shown in Table 1 indicate the different rate increase paths of policyholders in the various rate classes. Higher risk categories such as PFS policies have seen cumulative increases of 20 percent in policy costs from 2014 rates to 2016 rates. The significantly lower rate increase for this policy class in 2016 may be indicative of FEMA concerns that rates were increasing too rapidly. Additionally, post-FIRM A zone policyholders have absorbed 18 percent cumulative premium increases from 2014 rates.

According to GAO, policy concerning the velocity of rate increases is critical for consumers as it affects the timeline of subsidy removal and therefore policy affordability. Of particular importance to PFS policyholders, FEMA has not yet disclosed the agency’s plan to comply with the Biggert Waters Act mandate of actuarial rates in this rate class. Of additional concern are the impacts of continued increases in post-FIRM A and V zones that will affect grandfathered property owners where structures were constructed in compliance with elevation standards pursuant to a prior FIRM.

Table 2 and Table 3 illustrate why the velocity of rate increases are particularly important to PFS policyholders, who represent more than 1 million insureds. Table 2 calculates policy costs for a PFS policyholder under rate tables effective November 2015 where there is no elevation data concerning the insured structure. As it is reasonable to assume many PFS insured structures have a negative elevation, Table 3 estimates actuarial policy costs for the same coverage in Zone A with a -1 BFE.
Using the premiums calculated in Table 2 and Table 3, the sample PFS policyholder must absorb premium increases that will result in an estimated actuarial premium of $3,142 for a total policy cost of $3,688. This estimate results in additional required premium of $1,890. The following chart illustrates the consumer impact based on rate increase paths taken to achieve the estimated actuarial rate for the consumer under four rate scenarios—

These scenarios validate GAO data showing velocity of NFIP premium increases has a significant impact on policy affordability in the short-term. If NFIP opts for 18 percent year-over-year rate increases for certain PFS policyholders, consumers in this scenario reach the actuarial rate by year 7.\(^{37}\) If NFIP opts for 15 percent year-over-year rate increases, the actuarial rate will be exceeded by year 8. Annual increases of 10 percent will achieve actuarial rates in approximately 11 years, with 5 percent increases requiring as many as 20 years to reach full risk rates.

\(^{37}\) While NFIP may increase premiums on a single policy by as much as 18 percent per year (42 U.S.C. 4015(e)(1)), the NFIP is constrained by statute which dictates that no single premium class may receive a greater than 15 percent premium increase on average (42 U.S.C. 4015(e)(3)).
If FEMA opts for an average year-over-year premium increase of 10 percent, as is the case for the average of 2015 to 2016 for PFS policies, it is reasonable to assume PFS policy holders will reach projected actuarial rates within 11 years. The planned trajectory of flood insurance premiums is information material to the financial stability of PFS households and should be disclosed.

PFS policyholders additionally deserve to be informed of NFIP’s price target necessary to reach full risk-based policy costs—the point at which automatic rate increases will cease. This is more than for the purposes of apprising consumers of premium rate risk, it is also necessary for NFIP to ensure policyholders are not charged risk-based rates that exceed the actuarial rate.

Congress has tasked NFIP with managing several variables in the premium calculation. These variables include establishing a maximum (actuarial) rate, limitations on annual premium increases, and a directive to strive to minimize the number of policies with a premium to coverage ratio of greater than one percent. This requires that NFIP validate eventual premium targets and rate paths to that will be taken to achieve these premium outcomes.

Disclosure of both premium rate risk and estimated actuarial rates will allow PFS policyholders and communities to plan for implementation of actuarial pricing. Disclosure will also provide policymakers benchmarks for NFIP to achieve actuarial soundness within the limitations of the program’s authorizing statute.

Recommendations:

1) **NFIP should disclose to policyholders total premium and policy costs that reflect a full risk policy for the insured structure based on current or best available information.**

2) **NFIP should disclose to PFS policyholders the current projected year-over-year premium increases necessary to meet NFIP’s target timeline to achieve the projected full risk rate policy rate.**

**Incentives to Collect Elevation Data**

The key metrics for determining total NFIP policy costs and therefore affordability are property elevation and NFIP rate increase velocity. As has been documented by NAS, elevation data on a substantial majority of NFIP policies, including PFS policies and grandfathered policies, are largely unavailable. The lack of elevation data significantly limits affordability forecasts as the rate impact of an insured structure’s elevation relative to BFE is substantial in higher flood risk zones.

Policyholders without elevation certificates may pay higher premiums than are necessary if the insured structure’s elevation is at or above BFE. Alternatively, elevation data may put other policyholders at

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38 42 U.S.C. § 4015(e)(2), (3), and (4).
39 National Academy of Sciences, *Affordability of National Flood Insurance Premiums, Report 2* (Washington, D.C., 2016): p. 70. NAS reports that approximately 70 percent of NFIP policy records contain no elevation data. This is largely a result of NFIP not requiring elevation data for PFS policies or policies not located in an area having a high risk of flood.
great risk of unaffordable premium increases if an elevation certificate shows a negative elevation relative to BFE. To collect reliable data on flood risk and to accurately calculate the value of the subsidy for PFS policies FEMA must incentivize policyholders to obtain and disclose elevation data.

Resistance to determining elevation if the data lead to higher flood insurance premiums is economically rational for consumers as the impact of NFIP rate increases on homeowners is profound. According to the RAND Corporation, a $500 increase in flood insurance premiums may result in a corresponding loss of as much as $10,000 in property value. Applying this standard to the consumer in Table 3, the consumer will lose as much as $30,000 in home equity and face the prospect of the home’s value being less than the unpaid principle balance on the mortgage.

In addition to the negative impact on household finances, increases in flood insurance premiums may have significant impacts on local governments as reduced property values drive down tax assessments. The recent economic recession where millions of homes had market values well below the unpaid balance of mortgages stifled local economies and stalled real estate markets. To avoid this outcome and to incentivize collection and reporting of elevation data, NFIP premium rate increases should be constrained until elevation data is obtained and insureds who obtain elevation data should have rate risk reduced.

It is in the best interests of both NFIP and consumers to have validated elevation data. Absent elevation data, FEMA must estimate target actuarial rates and consumers may be charged higher rates as a result. Without elevation data, consumers lack key information necessary to make economically rational choices concerning mitigation opportunities. Further, NFIP participating communities lack basic information to guide floodplain management activities. To overcome barriers to obtaining elevation data and to realize the full benefits of having such data, FEMA must incentivize the collection and reporting of elevation data.

Recommendations:

1) **Incentivize policyholders to obtain and make available elevation data in exchange for a guaranteed year-over-year rate increase schedule.** Certainty of housing costs is an important aspect of household financial stability. Long-range certainty of household expenses may be sufficient to overcome insured fears of incurring higher flood insurance premiums in the near-term.

2) **Offer existing PFS and post-FIRM policyholders without an elevation certificate a one-time rate credit for the cost of obtaining elevation data.** According to FEMA the costs to obtain an elevation certificate vary from $500 to as much as $2,000 and in some cases may be too great for certain households to bear. Offering a premium credit for the cost of obtaining an elevation certificate will allow insureds to recoup costs that may be a barrier to obtaining data. Additionally, such a credit may offer market incentives for engineering firms and surveyors to more aggressively market elevation certificate services to policyholders with market competition reducing consumer costs.

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3) **Partnering with participating communities and state governments to obtain elevation data.** NFIP should offer Community Rating System (CRS) credit for participating jurisdictions that require an elevation certificate to be prepared at a subsequent transfer of title for structures in a flood zone where elevation data are not available. Under the current CRS Coordinator’s Manual, participating communities are actively discouraged from collecting elevation data on pre-FIRM structures in areas designated as Special Flood Hazard Areas (SFHAs). The manual states—

“The CRS prefers to see no buildings in the floodplain rather than provide credit for records on those that have been built.”

This policy is short-sighted given the lack of elevation data on pre-FIRM structures and NFIP’s statutory directive to charge no more than the full risk rate for flood insurance. The CRS manual notes lack of elevation data is “one of the greatest impediments to selling flood insurance.” Lack of elevation data is also one of the greatest impediments to NFIP complying with its mandate to charge no more than actuarial rates. The ability to reduce rates for communities committed to obtaining elevation data may offer greater assurances and rate certainty to policyholders.

4) **Continued partnerships with states governments to improve quality and frequency of elevation data collected through alternate means.** The use of Light Detection and Ranging (LiDAR) remote sensing technology reduces the cost of collecting elevation data and improvements to technology may allow FEMA and state governments to develop structure specific elevation datasets. Congress should continue to support FEMA, other federal agencies, and state governments in the development of LiDAR datasets. Congress should constrain FEMA rate setting authority based on LiDAR data until NFIP can demonstrate that data are being used on a comprehensive basis to preemptively reduce flood risk and that NFIP remains accessible to consumers on the basis of affordability.

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43 Ibid., p. 310-2.