

After the Deluge: The National Flood Insurance Program

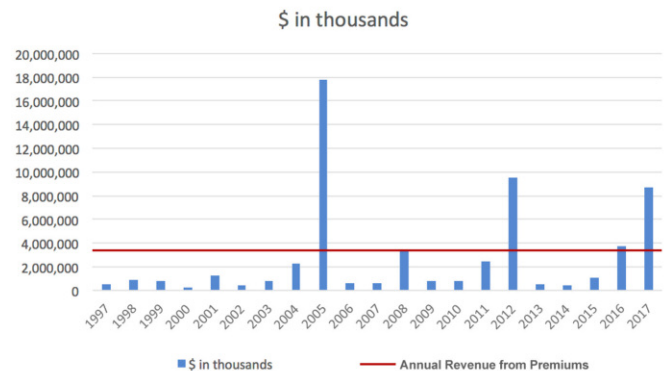
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It is a truth universally acknowledged that a homeowner in possession of a coastal property is in need of flood insurance. Insurance is typically a state-by-state, insurer-by-insurer enterprise. However, the National Flood Insurance Program (NFIP) was created in 1968 as a “reasonable method of sharing the risk of flood losses ... making flood insurance coverage available on reasonable terms and conditions to persons who have need for such protection.” (P.L. 90-448, as amended; 42 U.S.C. §§ 4001-4084.) When enacting the law, Congress found that it was “uneconomic for the private insurance industry alone to make flood insurance available ... on reasonable terms and conditions.” The theory was that the scale of participation offered by the federal government would make the insurance affordable.

Problems Facing the National Flood Insurance Program

However, revenue from insurance premiums have not kept up with the payouts for losses. The scale of recent catastrophes forced the agency managing the flood insurance program, the Federal Emergency Management Agency (FEMA), to borrow \$30.425 billion, its statutory maximum. (42 U.S.C. § 4016(a).) The NFIP is before Congress for reauthorization and possibly amendment. Congress must weigh the fact that homeowners in areas with frequent flooding are finding they cannot afford the premiums, against how much taxpayers should give to people who live where there are frequent floods, especially beachfront properties.

According to FEMA, policy holders pay \$3.32 billion a year in premiums.¹ Paid losses range from a 20-year low of \$251,721,000 (2000) to a 20-year high of \$17,770,443,000 (2005).



Homeowners and Insurance

It is not just FEMA that has struggled with the numbers. Many homeowners have found the NFIP model unsustainable. The NFIP authorizes FEMA to issue the standard flood insurance policy (SFIP). The maximum covered loss under the SFIP for a home is \$250,000, plus an additional \$100,000 for damaged contents. In May 2018, the average price of a new home in the United States was \$368,500.² While older construction is generally cheaper, the \$250,000 cap also applies to coastal properties where prices are higher. Those who can afford additional coverage buy from private insurers.

Many homeowners are trapped because they cannot afford to move and so must pay rising insurance costs to live in a home that likely will suffer more flood damage. In one case, the homeowner acquired an SFIP, but when his mortgage was purchased by another bank, the new bank required additional flood insurance to equal the replacement value of the home, far above the \$250,000 SFIP cap. The additional policy was expensive for the homeowner, whose property was located in a special flood hazard area. The court held the bank had the right to require additional private insurance.³

It is a myth often repeated that the NFIP has prevented private insurers from entering the flood insurance market. In fact, private insurance companies issue 88 percent of all SFIPs,⁴ but those policies are underwritten by the federal government (meaning it covers the losses) and the terms and coverages are the same as if issued directly from FEMA. Under the NFIP, FEMA is authorized to set rates based on operating costs and reasonable estimates, including the transfer of risk,⁵ which is consistent with how a private insurer would calculate rates. Instead of being blocked from the market, insurance companies have the opportunity to offer insurance policies that they underwrite. The fact that there is an impression that these policies do not exist may be due to the cost of issuing policies without the full faith and credit of the U.S. government acting as the underwriter, claims payer, and sustainer of losses.

Repetitive Loss Properties and Premiums

According to FEMA in 2008, 25 to 30 percent of all flood insurance claims come from “Repetitive Loss Properties” (RLP), which are properties that have had at least two flood claims in a 10-year period.⁶ As of January 2016 FEMA had identified 150,000 structures as RLP, representing just one percent of properties insured by FEMA, despite accounting for more than a quarter of its payouts.⁷ In more manageable terms, this is as if the first person in line for a 100-person buffet took 30 percent of the food. It is not a sustainable business model.

While homeowners complain about SFIP premiums rising, their premiums do not represent the true market rate. Yet the NFIP restricts FEMA from raising premiums beyond a congressionally-set point. Conversely, FEMA reduces premiums for certain properties constructed and not substantially improved prior to 1975. The theory is that because the flood maps were issued December 31, 1974, those properties could not have avoided building in a flood-prone area. The premium subsidy means just over 16 percent of properties in flood plains have not paid an actuarially-sound premium rate for over 40 years.⁸ Thus, those properties’ premiums do not represent the true risk of a loss due to flooding. Despite phasing out the premium subsidy for those properties, it will be years before that portion of the NFIP books are balanced. To extend the 100-person buffet analogy, premium payments are a pot-luck buffet where everybody brings a dish. The first person in line (representing RLP) takes 30 of the 100 dishes. The next 16 people (the reduced-premium properties) brought only 10 dishes total, but they still take 16.

Congressional Response

It appears that Congress has also found the program unsustainable, but it has not come up with a solution. The program was set to expire most recently on July 31, 2018, and bills were proposed to overhaul the program. Instead, Congress chose to give it some more thought and passed a short-term extension of the program. Reportedly, it is the 41st time in 20 years that Congress has reauthorized the program on a short-term (meaning one year or less) basis; in all but three times the extension did not make any changes to the program.

Congressional attempts at improving the NFIP have addressed RLP. For example, under a pilot program authorized by the Flood Insurance Reform Act of 2004, 28,000 properties were bought out or physically elevated to avoid future flood damage. None of the properties in the pilot program were in Alabama or Mississippi.⁹ Notably, according to the Natural Resources Defense Council (NRDC), 75 percent of all current RLP homes are valued at less than \$250,000, the maximum payout,¹⁰ perhaps presenting an opportunity to buy out more properties. However, the law was eliminated by the Biggert-Waters Flood Insurance Reform Act of 2012.

Community Rating System

The Community Rating System (CRS) is another attempt by the federal government to limit catastrophic losses from flooding. CRS targets communities with flood zones to help them develop preventative measures and gives incentives to reduce the impacts from flooding. Communities’ participation is rewarded by reductions in NFIP insurance premiums for homes and businesses. Floodplain mapping is one way to participate, resulting in Flood Insurance Rate Maps (FIRMs). Those FIRMs identify Special Flood Hazard Areas (SFHA) for areas with a higher risk of flooding, specifically, where there is at least a one percent chance of flooding each year. The CRS gives incentives to communities to address the problems. There are four main conditions required of communities to participate. The community must:

- Require permits for development,
- Require the lowest floor of new residential buildings to be elevated at or above the Base Flood Elevation (which varies based on local conditions),
- Restrict development in floodplains, and
- Require construction materials and methods to minimize future flood damage.

Only 5 percent of eligible communities participate in the CRS as of last summer, according to the Congressional Research Service, although 69 percent of all flood policies are from CRS communities. Notably, a FEMA document with RLP frequently asked questions states that 25 percent of flood claims were for properties outside of the SFHA, frequently because flooding was caused by stormwater due to inadequate local drainage.

NFIP Limits

The NFIP imposes some limitations on claims. The NFIP requires that a proof of loss be filed within 60 days. However, following wide scale natural disasters, that deadline is frequently extended, to allow for the fact that homeowners are frequently displaced by the loss. For example, following Hurricane Sandy, FEMA allowed proofs of loss to be filed for two years. Following Hurricane Katrina, the deadline was one year. Courts will dismiss claims for coverage for failing to file the proof of loss in time:

- **Reine v. State Farm Ins. Co.**, 2015 WL 770423 (E.D. La. Feb. 23, 2015): Following Hurricane Isaac the proof of loss time was extended to 240 days, but the homeowners could not demonstrate that they submitted a timely proof of loss.
- **LCP West Monroe LLC v. Selective Ins. Co. of Southeast**, 2018 WL 2292534 (W.D. La. May 18, 2018): Following a March 2016 flood the proof of loss deadline was extended to 120 days. The insured filed several proofs of loss over time, with the latest being more than 120 days after the loss. The insurer denied the one submitted after the deadline. The court dismiss the claims as untimely.
- **Marseilles Homeowner Condominium Ass'n, Inc. v. Fidelity National Ins. Co.**, 542 F.3d 1053 (5th Cir. 2008): Following Hurricane Katrina, the court of appeals held that an insurer cannot waive the NFIP requirement of filing a signed proof of loss. Because no proof of loss was filed, the condo association's suit to recover \$642,000 for damages was dismissed.

If the proof of loss was timely, and the insurer denies coverage completely or in part, suits challenging the denial or amount of coverage must be brought in federal court. Typically, federal courts are slower to resolve disputes than state courts. However, jurisdiction in federal court means that the parties likely are before a court that is familiar with

the program and that cases from around the country are handled uniformly. If the insurer denies the claim, the homeowner must file suit within one year of when the insurer *mails* the denial of the proof of loss (42 U.S.C. § 4072):

- **Choleankeril v. Selective Ins. Co. of America**, 2016 WL 3769352 (D.N.J. July 14, 2016) Following Hurricane Sandy, the claim is dismissed for being filed too late. One year is counted from when the insurer mails the claim denial, and not when the homeowner receives it.
- **Woodson v. Allstate Ins. Co.**, 855 F.3d 628 (4th Cir. 2017): Following Hurricane Irene, the homeowner filed suit in state court within one year of denial of coverage, but NFIP claims must be filed in federal court. The homeowner could not recover over \$200,000 in damages because it did not file in time in the right court, even though the insurance company knew of the claim and the suit.

The NFIP limits what types of claims may be brought. Claims against the insurance company for not getting the policy right are excluded, as are punitive damages, state law claims, and also expenses for relocation and temporary housing. Examples of homeowners who found their SFIP policy did not cover flood-caused damage to their property are described in *Read the Fine Print: Flood Insurance Details and Deceptions*, later in this edition of *Water Log*.

Other owners are surprised when damage from a boat smashing into structures on land is not covered by insurance, no doubt believing insurance should cover expenses for occurrences outside of the control of the homeowner. In New York, one such case was excluded under a private insurance policy's "surface water exclusion." Discussion of what happened when casino barges demolished property in Mississippi following Hurricane Katrina is in the article, *The Expert's Magic Words: Exploring Outcome-Determinative Testimony in Hurricane Katrina Recovery Cases*, later in this edition. Here are some other examples of coverage limitations:

- **Collins v. First Community Bank**, 2018 WL 1404289 (S.D.W.V. March 19, 2018): Following a June 2016 flood, the court held that the NFIP limited the damages sought by the homeowner to direct physical losses from flood and debris removal, and dismissed the claims for reimbursement for loss of use and attorneys' fees.

- **Avery v. American National Property & Casualty**, 2012 WL 12894806 (S.D. Tex. Feb. 2, 2012): Following Hurricane Ike the homeowner learned it was not covered “down to the bottom” of the home as a pre-FIRM property, because the insurance agent was wrong about the home’s being pre-FIRM. The suit was sent to state court for review because it was not a covered claim under SFIP.

Conclusion

While the NFIP appears to please neither the covered homeowners, the federal budget, nor the public in general, it is a system that provides insurance to people, many of whom would face catastrophic financial damages without it. According to the Congressional Research Service, as of February 2018, the NFIP had issued more than 5 million flood insurance policies guaranteeing nearly \$1.28 trillion in coverage. Increased severe weather and a larger population in coastal counties means claims for flood damage will continue to outpace the premiums collected. Congress will have to legislate the solution, but it has indicated it prefers to avoid the question. In fact, it had created a program to remove the most flood-prone properties from the books, under the Flood Insurance Reform Act of 2004, but a subsequent Congress ended the program less than a decade later. While Congress may continue to avoid accountability, ignoring the problem will not change the fact that flooding will continue and homes likely will be underinsured, leaving

the repairs to the taxpayers, or the unrepaired property as blight on its neighbors. 🐼

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Endnotes

1. FEMA, *Policy & Claims Statistics for Flood Insurance* (last updated Nov. 30, 2017) (based on 2016 data).
2. U.S. Census Bureau, *Median and Average Sales Prices of New Homes Sold in United States* (Jan. 1963 – May 2018).
3. Kolbe v. BAC Home Loans Servicing LP, 738 F.3d 432 (1st Cir. 2013).
4. Diane P. Horn and Jared T. Brown, *Introduction to the National Flood Insurance Program (NFIP)*, p. 13 (R44593) (Congressional Research Service, April 30, 2018) (hereinafter *CRS Report*).
5. 42 U.S.C. § 4015.
6. FEMA, *FEMA Grant to Assist Frequently Flooded Homeowners* (R3-08-025, Feb. 15, 2008).
7. Rep. Ed Royce Press Release, *Bipartisan Repeatedly Flooded Properties Insurance Reform Introduced* (March 16, 2017).
8. CRS Report, p. 15.
9. FEMA, *Hazard Mitigation Assistance Severe Repetitive Loss (SRL) data – FEMA Hazard Mitigation Assistance (HMA) Grant Programs* (excel chart).
10. NRDC Press Release, *Report: Homeowners Trapped by Repeated Flooding Under Troubled Flood Insurance Program* (July 25, 2017).
11. Spindler v. Great Northern Ins. Co., 2016 WL 921646 (E.D.N.Y. Feb. 2, 2016) (following Hurricane Sandy).



IN SUM.

A Summation of the Facts and Figures of Interest in this Edition

★ Number of years after Hurricane Katrina swept casino barges into houses and docks that the Mississippi courts were still reviewing the cases:	11
★ Maximum reimbursement for residential real property damage under Standard Flood Insurance Policy (SFIP) issued under the National Flood Insurance Program:	\$250,000
★ Average cost of a new home in 2018:	\$368,500
★ Percentage of SFIPs issued by insurance companies and not the Federal Emergency Management Agency (FEMA):	88
★ Maximum statutory borrowing limit for FEMA to pay for flood claims:	\$30,425,000,000
★ Amount FEMA has borrowed:	\$30,425,000,000
★ Percent of eligible communities participating in the FEMA flood impacts reduction program, the Community Rating System:	5