THE MANDATORY PURCHASE REQUIREMENT: ORIGINS AND EFFECTIVENESS IN ACHIEVING NFIP GOALS

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Executive Summary

- Congress created the flood insurance mandatory purchase requirement (MPR) in 1973 to encourage more communities to join the National Flood Insurance Program (NFIP) and more households to purchase flood insurance.

- Greater participation in the program and take-up of flood insurance were desired to achieve three NFIP goals:
  1) reduce flood damages through adoption of NFIP-mandated floodplain management regulations in participating communities,
  2) limit increased spending on federal disaster aid by lowering flood damages and making insurance the primary tool for financial recovery, and
  3) improve post-flood financial recovery by increasing the number of people with flood insurance.

- The MPR requires federally-backed or regulated lenders to require borrowers to purchase and maintain a flood insurance policy when they provide a mortgage in a 1% annual chance floodplain, as mapped by the Federal Emergency Management Agency (FEMA). It also requires those who receive federal assistance for property acquisition, construction, or repairs in a mapped 1% annual chance floodplain to purchase and maintain flood insurance or they will not be eligible for post-flood disaster assistance in the future.

- The MPR has been successful in stimulating community enrollment in the NFIP and adoption of NFIP-required floodplain management regulations. These regulations have reduced flood damages relative to what they might have been without the regulations. However, there are limits to the ability of these NFIP-required regulations to continue to reduce flood damages. Adoption of cost-effective flood risk management programs, responsive to future changes in flood hazard, will require intergovernmental actions beyond the MPR.

- Since most disaster aid is not directed to individuals (let alone their insurable property losses), expanding residential flood insurance take-up will do little to reduce federal disaster aid.

- The MPR increased take-up rates of flood insurance among those subject to the requirement, but the MPR does not apply to many households in areas subject to flooding. These include households with property that does not have a federally-regulated or federally-backed mortgage and households outside the 1% annual chance floodplain. Encouraging flood insurance purchase by these households will require changes to the MPR or new programs aimed at spurring voluntary purchase of flood insurance.

1. Introduction[1]

In the United States, flood insurance has been available since 1968 through the federal National Flood Insurance Program (NFIP), now administered by the Federal Emergency Management Agency (FEMA). When a local community voluntarily enrolls in the NFIP, they must adopt minimum floodplain management regulations, which govern new construction in the mapped 1% annual chance floodplain, also known as the Special Flood Hazard Area (SFHA). In exchange, their residents become eligible to purchase flood insurance policies through the federal program.

The first NFIP policy was sold in 1969, but by 1973, few communities had enrolled in the program and few flood insurance policies had been purchased. In December of that year, Congress legislated the mandatory purchase requirement (MPR), mandating flood insurance on properties in the mapped SFHA when purchased with a loan from a federally-regulated or federally-backed lender. Flood insurance was also required in the SFHA whenever federal assistance was provided for property acquisition or repairs. Enforcement of the MPR is a responsibility of mortgage lenders for the former requirement and by the federal agency providing assistance for the latter requirement. After the MPR went into effect, the number of communities enrolled in the NFIP grew rapidly, as did the number of properties with flood insurance coverage. That said, despite the MPR, an insurance coverage gap remains for many properties at risk from flooding.

This report examines the motivation behind creation of the MPR and the extent to which it is still meeting original policy goals. We begin in Section 2 with a description of how the MPR operates today. In Section 3, we present Congress's goals for the NFIP and explain why Congress enacted the MPR as a way to secure those goals. Section 3 also briefly discusses reforms of the MPR over time. In Section 4, we discuss how effective the MPR has been in advancing the three original goals for the NFIP and describe the current limits to the MPR design further advancing those goals today. Note that we do not examine compliance with the MPR, an ongoing issue that has been considered at length elsewhere.[2]

2. Overview of the MPR Today

Who is subject to the MPR?

Today, the MPR applies to three types of property owners with homes located in the SFHA of participating communities:[3]

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[1] This report is based on work supported by the Science and Technology Directorate of the US Department of Homeland Security for the Flood Apex Program under Contract HSHQDC-17-C-B0032. The views and conclusions contained in this document are those of the authors and should not be interpreted as necessarily representing the official policies, either expressed or implied, of the US Department of Homeland Security. The authors would like to thank the following individuals for their helpful comments: Elizabeth Asche, Niki Crewes, Tyler Corson-Rikert, David Goldberg, Howard Kunreuther, Clark Poland, and Melissa Anderson.

[2] For example, see: GAO 2002, Dixon et al. 2006, Dixon et al. 2013, and Dixon et al. 2017.

[3] Homes located in the 1% annual chance floodplain in nonparticipating communities are ineligible for flood insurance from the NFIP and for federal financial assistance for home construction or acquisition. While federally-

(1) those with a property loan issued by a federally-regulated lender;
(2) those with a mortgage backed by the federal government (such as by the Federal Housing Administration, the Department of Agriculture, or the Department of Veterans Affairs) or a mortgage that has been transferred to a government sponsored enterprise (Fannie Mae or Freddie Mac); and
(3) those who receive federal assistance for property acquisition, construction, or repairs.[4]

Mortgage lending institutions that originate or service mortgages are responsible for enforcing the first two applications of the MPR. Federal agencies distributing assistance enforce the third.

How much coverage is required?[5]

Borrowers subject to the MPR must purchase flood insurance before closing, and maintain coverage until the mortgage is fully repaid. The required coverage amount is the lesser of:

(1) the outstanding principal balance of the loan,
(2) the maximum amount of coverage available from the NFIP (currently $250,000 for one-to-four-dwelling residential structures), or
(3) the insurable value of the property (i.e. the value of the structure, not the land).

For recipients of federal assistance for construction or acquisition, the required coverage amount is the lesser of:

(1) the structure's development or project cost[6] (minus the estimated land cost), or
(2) the maximum amount of coverage available from the NFIP.

How is the MPR enforced when a new home is purchased?

Before closing on a property loan that may fall under MPR requirements, a lender must first determine whether the structure is located in the SFHA and therefore subject to the MPR. The lender typically relies on a flood hazard determination company to make this assessment and complete the statutorily required Standard Flood Hazard Determination Form.[7] This flood determination for a given property is valid for seven years, as long as FEMA does not update the relevant flood maps.

If the lender determines that the property is located within the SFHA, it must provide a notification to the borrower that includes:

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regulated lenders may still extend loans for these properties, lenders must notify such borrowers whether they will be eligible for federal disaster assistance for flood-related damages.

[4] This type assistance is generally provided by agencies such as the Small Business Administration, the Department of Agriculture, the Department of Veterans Affairs, the Federal Emergency Management Agency, or the Department of Housing and Urban Development.

[5] Coverage requirements are provided in section 102(a) and (b) of the Flood Disaster Protection Act of 1973. See: https://uscode.house.gov/.

[6] Project cost is generally defined as the "total allowable costs incurred under a Federal award and all required cost sharing and voluntarily committed cost sharing, including third-party contributions." See: https://www.grants.gov/learn-grants/grant-terminology.html.

[7] See: https://www.fema.gov/media-library/assets/documents/225.

- a warning that the structure is or will be located in the SFHA,
- a description of the flood insurance purchase requirements set forth in federal law,[8]
- a statement that flood insurance is available from both the NFIP and private insurers, and
- a statement on the availability of federal disaster assistance if the structure experiences flood damage in a federally-declared disaster.

The lender must provide this notice within a reasonable time period and maintain a record that this information was provided to the borrower (such as a signed document) for the life of the loan.

How are lenders regulated regarding the MPR?

The supervisory agencies that are responsible for ensuring the implementation of the MPR by lenders are The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Farm Credit Administration (FCA).[9] These agencies monitor their respective institutions for compliance with a wide range of consumer protection laws and regulations. Failure to enforce the MPR over the life of the loan makes the lender subject to a fine.

How is the MPR enforced over the life of a loan?

Lenders are responsible for assuring that a property owner maintains the required NFIP coverage. This lender responsibility is for the loans they originated regardless of whether the loans continue to be held in their own portfolios, are insured or guaranteed by a federal agency, or are sold to Fannie Mae or Freddie Mac—the government-sponsored enterprises (GSEs). Lenders may service loans themselves, but if loan servicing responsibilities are transferred, the servicer monitors loans for MPR compliance and ensures flood coverage is maintained over the life of the loan. Servicing involves the administrative aspects of a loan such as sending statements, collecting payments, maintaining records, managing escrow accounts, paying taxes and insurance, and following up on delinquencies. There are some servicers that specialize just in flood and MPR compliance. If over the course of a loan, the lender/servicer finds that a structure subject to the MPR has less flood coverage than is required, they must notify the borrower and instruct them to obtain the proper amount. If the borrower has not done so, the lender/servicer must force-place coverage[10] as soon as the borrower's flood policy lapses or does not provide sufficient coverage.

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[8] These requirements are provided in section 102(b) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4012a(b)). See: https://uscode.house.gov/.

[9] The FRB regulates state-chartered banks that are members of the Federal Reserve System (FRS). The FDIC regulates state-chartered banks that are not members of the FRS. The OCC regulates all national banks (i.e. those that are FRS members and have a federal charter). The NCUA regulates federally-chartered credit unions and state-charted, federally-insured credit unions. The FCA regulates the banks, associations, and related entities of the Farm Credit System. The 1973 Act directed these agencies (including the now-dissolved Office of Thrift Supervision and excluding the Farm Credit Administration, which was added to this group in 1994) to issue regulations governing the implementation and enforcement of the MPR among the institutions they oversee.

[10] That is, the lender must buy flood insurance on the borrower's behalf and charge the borrower for the cost of coverage. Lenders are allowed to force-place coverage on the day they notice the property has insufficient coverage.

Since 2012, mortgage lenders/servicers have been required to escrow flood insurance premiums and fees for all loans unless a specific exception applies, even if premiums for other insurance and taxes are not being escrowed.[11] When flood insurance is escrowed, borrowers pay the insurance costs to their lender/servicer along with their monthly mortgage payment. The lender then makes payments to the insurer on the borrower's behalf.[12] This escrow requirement is meant to increase policy retention and make it easier for borrowers to pay premiums by spreading them over the course of the year.

The MPR oversight responsibility remains with the lender/servicer even if the loan is sold to Fannie Mae or Freddie Mac; this is a component of GSE contracts with lenders. Through their contracts, GSEs require servicers to have processes in place to identify flood map changes, identify which properties impacted by those changes need flood coverage, and ensure that those borrowers get flood insurance within 120 days of the change (GAO 2002). While the five regulatory agencies noted above can assess fines and penalties on noncompliant lenders, Fannie Mae and Freddie Mac cannot. Instead, if the GSEs find that a lender fails to comply with flood requirements, they may require the lender to buy back their loans and correct issues with flood monitoring and compliance.[13]

How is the MPR enforced when tied to federal assistance?

The MPR also applies to those who receive federal assistance to construct, reconstruct, repair, or purchase a home in the SFHA. Such assistance is typically provided through federal disaster assistance programs, or federal programs that support homeownership. Assistance may come in the form of a grant, loan, loan guarantee, or mortgage insurance. Specifics around the MPR can vary based on the agency providing assistance, the type of assistance, and other factors.

Most disaster assistance is distributed through the Small Business Administration's (SBA) Disaster Loan Program, the Department of Housing and Urban Development's (HUD) Community Development Block Grant – Disaster Recovery (CDBG-DR) program, and FEMA's Individual Assistance (IA) Program. Under the SBA program, loan applicants with homes in the SFHA must provide proof of flood insurance prior to obtaining a loan. While flood coverage is required for the life of the loan, the SBA does not monitor whether flood insurance is retained after loan origination. If an SBA loan is sold (such as to a bank or other financial institution), the loan buyer assumes responsibility for ensuring the property owner maintains flood insurance (Tobin and Calfee 2005). For HUD grant programs, a "responsible entity" such as a local, state, or tribal government that oversees a project is responsible for enforcing the MPR on relevant grant recipients in the SFHA. The "responsible entity" must make a flood hazard determination, determine the amount of flood insurance the homeowner is required to have, and monitor and ensure that the proper amount of flood insurance is maintained for the life of the structure. Under FEMA's

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[11] For example, small lenders (those with less than $1 billion in assets) are not required to escrow flood premiums. For a full list of exceptions, see: https://www.ecfr.gov/cgi-bin/text-idx?SID=a95ccfc52ae456271d193195b7550771&mc=true&node=se12.2.208_125&rgn=div8.
[12] The MPR may be satisfied with a flood insurance policy from the NFIP or a private insurer. For more information on private flood insurance and the MPR, see: https://www.fdic.gov/news/news/financial/2019/fil19008.html.
[13] See: https://www.fanniemae.com/content/guide/selling/a2/3.2/01.html.

Individual Assistance program, grant recipients (and any future owners of the property) in the SFHA must obtain and maintain flood insurance on the damaged structure for as long as it exists. It is not clear if FEMA actively monitors flood insurance retention among grant recipients. However, if an IA recipient in the SFHA fails to maintain flood insurance and the structure suffers future flood damages, they would not be eligible for federal disaster assistance.[14]

The Federal Government provides homeownership assistance through HUD's Federal Housing Administration (FHA), the Department of Veterans' Affairs (VA), and the Department of Agriculture (USDA). The FHA provides mortgage insurance to borrowers that may not have the credit score or down payment needed to get a conventional loan. The VA and USDA offer loan guarantees as well as direct loans to eligible homebuyers. For mortgages originated by federally regulated lenders, and insured by the FHA or guaranteed by the VA or USDA, the MPR is enforced by the originating lender (or their contracted servicer). These responsibilities extend to non-federally regulated lenders that offer FHA/VA/USDA mortgages. Direct loans issued by the VA and USDA are maintained by private servicers who are responsible for monitoring flood insurance retention and MPR compliance over the life of the loan (Tobin and Calfee 2005).

3. History of the MPR

Creation of the NFIP

A 1966 consultant's report to Congress, *A Unified Federal Program for Managing Flood Losses*, identified flood insurance as a feasible policy for ensuring that occupants of floodplains recognized the expected costs of flood damages as a way to incentivize more economically efficient land use decisions (referred to as "wise use" of floodplains) (Task Force on Federal Flood Control Policy 1966). This same report stressed that wise use would require more than just financial signals from insurance, but would also necessitate limiting future flood damages through local floodplain land use and building regulations. The expectation was that taken together, risk-based insurance and land use regulations would limit, and then reverse, any national growth in flood damages, with the result being less need for post-flood disaster aid.

Since the Federal Government has no direct authority over local land use, Congress designed the NFIP to motivate local community adoption of floodplain management regulations. When the NFIP was created in 1968, local communities could voluntary join the program, but to do so, had to adopt minimum floodplain management regulations.[15] Once enrolled, all residents could purchase federally-backed flood

[14] See 44 CFR § 206.110 - Federal assistance to individuals and households, available here: https://www.ecfr.gov/cgi-bin/text-idx?SID=d7f4e094fb76c9ff25895debe5d4bd47&mc=true&node=pt44.1.206&rgn=div5.

[15] Participating communities must adopt and enforce minimum floodplain management regulations that: (1) require all new development proposals in the SFHA to obtain a permit; (2) prohibit new development in floodways if it increases flood heights; (3) require all new construction or substantially improved or damaged structures in the SFHA to be elevated so that the lowest floor is at or above base flood elevation. Communities must base all regulations on FEMA's most current flood maps. The minimum NFIP floodplain management requirements are

insurance. Flood insurance was not available through the private sector so the offering of insurance was expected to entice enrollment and adoption of floodplain regulations. Flood insurance policies for new construction would be charged risk-based premiums and existing property would be charged “reasonable premium rates through a federal subsidy,” (GAO 1979). The expectation was that new development would be built in less flood-prone areas and existing structures would be retrofitted or removed over time, ultimately reducing flood damages. For more on the early history of the program, see Shabman (2018).

The goals were clear, but there were some practical program design choices. Since joining the NFIP required the adoption of the minimum floodplain management regulations, communities needed flood maps depicting the area where the regulations would apply. The 1% annual chance floodplain was an early compromise on the extent of the floodplain where such regulations had to be enforced (for further discussion, see ASFPM Foundation (2004)). The Federal Government (first through the U.S. Army Corps of Engineers and then through FEMA) provided the flood hazard maps.

Through the 1970s, there were limitations in data, modeling and computational tools required to produce the necessary maps, which resulted in delays. In an effort to facilitate community enrollment, the “emergency program” was created to allow community enrollment in the program before an official Flood Insurance Rate Map (FIRM) was completed. During this emergency period, a community is required to adopt minimum regulations to govern future use of its floodplains and in turn a limited amount of flood insurance coverage becomes available to community residents at less than risk-based rates. When FEMA completes the FIRM, the community enters the “regular program” where stricter floodplain regulations are required and greater coverage is available. Today, almost 99% of all participating communities are in the regular program.

Increasing Participation and the Creation of the MPR

The emergency program was not a sufficient inducement for community enrollment, and for the communities that did enroll, there was limited demand for NFIP policies. As of 1973, when the Flood Disaster Protection Act of 1973 (FDPA) was passed establishing the mandatory purchase requirement, only about 10% of flood prone communities had joined the program and there were only 95,000 policies in force (Tobin and Calfee 2005). This low participation led to the creation of the MPR. The act was adopted following “congressional recognition of the national need for a more reliable and comprehensive flood insurance program to provide adequate indemnification for the loss of property and the disastrous personal losses suffered by victims” (GAO 1976, p.8).

Ensuring household recovery was not the only justification for creation of the MPR. In commenting on the 1967 HUD report to Congress that proposed a federal flood insurance program (published as an appendix), the Associate Director of the GAO, prior to passage of the 1973 Act, stressed the need to closely link land use regulation to the availability of flood insurance:

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provided in 44 CFR § 60.3. See: https://www.ecfr.gov/cgi-bin/text-idx?SID=20240ddab72535c966a47af9b5caee9c&mc=true&node=se44.1.60_13&rgn=div8.

> this new program…had to reverse the tendency of most local communities to expect to have their cake and eat it too—they wanted Federal aid but also carte blanche for irresponsibly building in flood plains… Most of these officials will either not admit such knowledge, or openly reject the program, because they choose not to deal with a non-giveaway Federal program that enforces standards of sound flood plain land use. *That is why the flood insurance program will never be a full success on a purely voluntary basis* and why the Flood Disaster Protection Act of 1973 is essential to securing broad coverage, adequate insurance protection, and better use of our flood plains (Federal Insurance Administration 1973, emphasis added by authors).

The link to land use is also found in the findings and declaration of purpose in the 1973 Act, which states that flood losses had been increasing "largely as a result of the accelerating development of, and concentration of population in, areas of flood…hazards."[16] This language makes clear that one purpose of the MPR was to engage more communities in regulation of floodplain development in order to secure the NFIP goal of reducing flood damage.

The MPR also grew out of the broader concern that post-flood federal disaster aid could potentially grow dramatically unless insurance was available and was purchased. It was argued that take-up rates should be expanded in order to facilitate "the ultimate reduction of Federal disaster-relief outlays through the substitution of insurance…" (GAO 1976, p.9). This was tied to concern that federal disaster aid could subsidize unwise floodplain development. As such, requiring flood insurance as a part of any aid provided would be necessary to offset those incentives. The 1973 Act notes that "the availability of Federal loans, grants, guaranties, insurance, and other forms of financial assistance are often determining factors in the utilization of land and the location and construction of…. facilities."

Achieving Congress' goals for the NFIP thus required broad community participation and then widespread take-up of flood policies. Congress established the MPR to secure this broader enrollment in the program. As such, the overarching goals for the MPR were the same as those for the program overall:

1) reduce flood damages through adoption of NFIP-mandated floodplain management regulations in participating communities,
2) limit federal disaster aid by lowering flood damages and making insurance the primary tool for financial recovery, and
3) improve post-flood financial recovery by increasing the number of people with flood insurance.

Note that at the time the MPR was adopted, the first goal for the NFIP was a primary driver of policy discussions. In the decades since then, the second and third goals have become of equal importance.[17]

[16] Source: Section 2 of the Flood Disaster Protection Act of 1973 (Pub. L. No. 93--234; 87 Stat. 975).

[17] We believe there is little evidence to suggest that the MPR was ever intended primarily to protect mortgage lenders from flood-related default risk. Almost all of the contemporaneous discussion and reports focus on limiting disaster aid and consumer protection, without any mention of the financial soundness of lenders – a secondary concern.

Designing Mandatory Purchase

Congress believed that mandatory purchase of flood insurance in high risk areas would make a substantial contribution toward advancing NFIP objectives. However, there was still the question of the policy mechanism and the geographic area where the MPR would apply—that is, who specifically would be required to obtain flood insurance. The 1966 consultant's report to Congress provided an early rationale for the MPR being linked to mortgages issued by federally regulated lenders. The report stated:

> To encourage widespread purchase of flood insurance… all lending institutions entrusted with savings or deposits and under any form of Federal supervision of insurance of savings or deposits shall require in high-risk areas flood insurance at unsubsidized rates on all new mortgages based on new residences, as they now generally require fire insurance; and that such flood insurance be considered in the interest of the borrowers, the lending institutions, and the savers and depositors; and these institutions might well encourage flood insurance by borrowers in low-risk areas (HUD 1966).

That same report also suggested that flood insurance be required as a condition of federal post-disaster assistance, although it suggested that assistance only take the form of a loan (such as is now available through the disaster loan program of the Small Business Administration) and the insurance requirement should extend only for the life of the loan.

The 1973 Act built on these suggestions, stating that "Federal instrumentalities insure or otherwise provide financial protection to banking and credit institutions, whose assets include a substantial number of mortgage loans... secured by property exposed to loss and damage from floods." A partial motivation was thus managing federal government exposure where it had assumed credit risk. Federal support of mortgages also provided the legal justification Congress needed to implement an insurance mandate.[18]

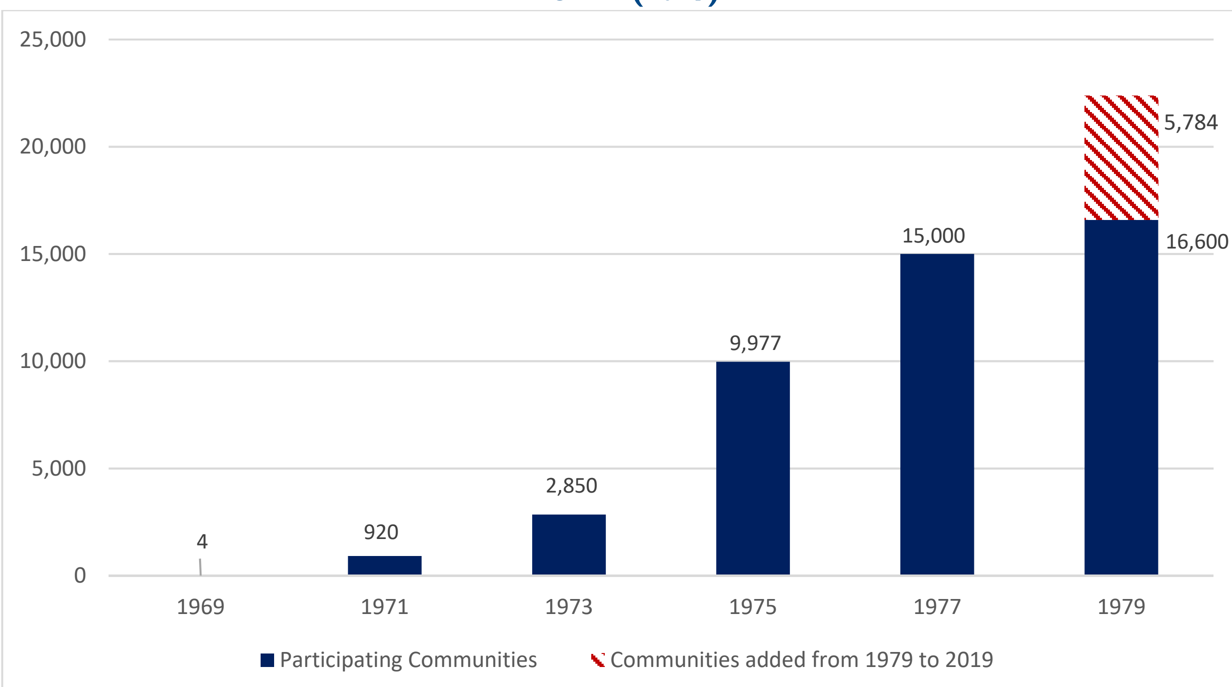
The next question was how to define those high-risk properties that should have coverage. The 1% annual chance floodplain had already been decided as the boundary for the floodplain regulations required for participation in the NFIP. Simply applying the MPR inside this boundary would facilitate the political acceptability of the new mandate and ease the administrative implementation. For more discussion on the history, use, and adequacy of the 1% annual-chance event as a regulatory standard, see the contributions in the edited volume by ASFPM Foundation (2004).

[18] The spending powers given under the Constitution allowed Congress to require a household to purchase flood coverage from a Federally regulated lender and when the loan was federally backed. The MPR did shield agencies offering federally backed mortgages from disaster driven credit default risk and moderated that risk for federally regulated lenders.

Community enrollment and NFIP take-up after MPR

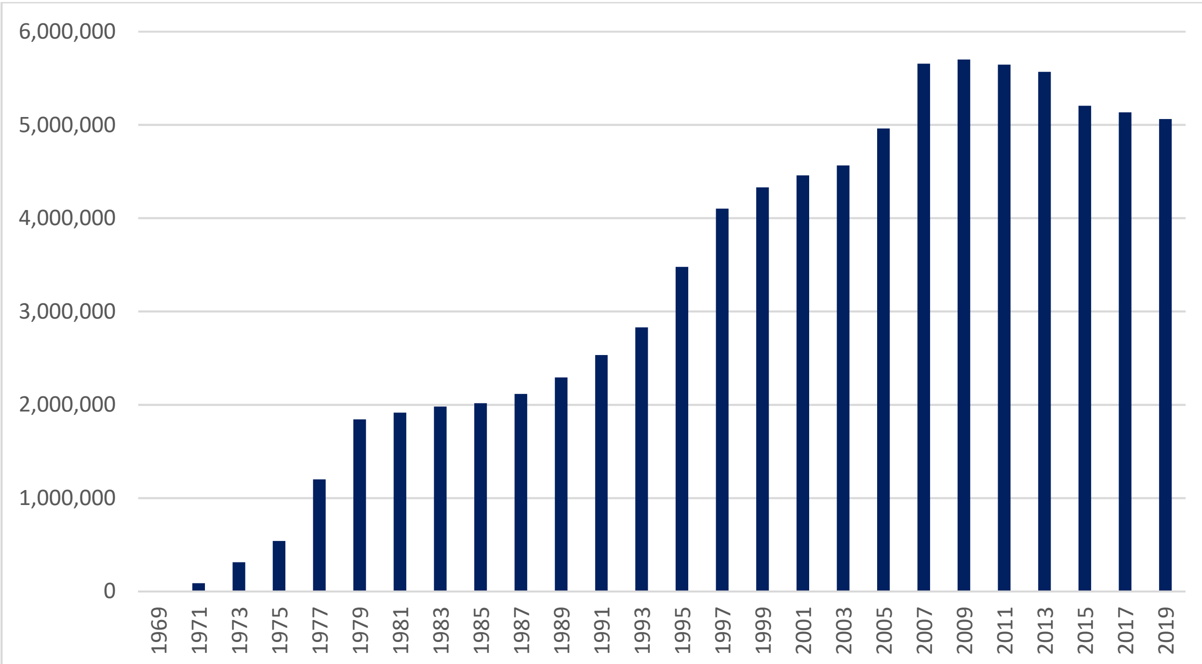
After the MPR requirement went into effect, the number of communities enrolled in the NFIP grew, as did the number of households with flood insurance (see Figures 1 and 2). In 1969, there were just four participating communities and a mere 16 policies in force. By 1973 the program had grown slowly to encompass 2,850 communities and 312,000 policies. By 1977, after MPR went into effect, the number of participating communities quintupled to more than 15,000 and the number of policies nearly quadrupled, reaching 1.2 million (The American Institutes for Research 2005). As of 2019, there were 22,384 participating communities and roughly 5.02 million policies in force. Thus, almost 75% of the current number of enrolled communities were already enrolled by 1979.

FIGURE 1. COMMUNITIES PARTICIPATING IN THE NFIP IN ITS FIRST DECADE (1969-1979) AND TODAY (2019)



Source: FEMA's NFIP Community Status Book and American Institutes for Research (2005).

Figure 2. NFIP Policies in Force 1969-2019



Source: FEMA and American Institutes for Research (2005).

Reforms of MPR

Congress has modified the mandatory purchase requirement four times since creating it in 1973. The 1977 reform relaxed the requirement that federally-regulated lenders deny loans to properties in the SFHA if the community does not participate in the NFIP. The 1994, 2012, and 2014 reforms increased the regulatory oversight of MPR enforcement in the belief that loan originators and servicers were not enforcing the MPR inside the SFHA. We now briefly discuss each reform.

The Eagleton Amendment (1977)

Congress made the first substantial change to the MPR in 1977 with the passage of the Eagleton Amendment (Title VII of the Housing and Community Development Act of 1977). The amendment eliminated a provision of the MPR that prohibited federally regulated lenders from making loans on SFHA properties in nonparticipating communities. Instead, the amendment required lenders to notify buyers or lessees of SFHA properties that federal disaster assistance would not be available following a federally-declared flood disaster. This does not appear to have ultimately lessened community participation as almost all communities at risk of flooding currently participate in the program.

National Flood Insurance Reform Act of 1994

Despite the MPR's initial success in enrolling more policyholders, Congress concluded between 1973 and 1994 that many policyholders were not retaining their policies and that enforcement of the MPR was weak.[19] Congress responded with the National Flood Insurance Reform Act of 1994 (King 2005). This act: (1) required banks to escrow flood insurance costs when they are escrowing other payments, enabling payment in monthly installments; (2) allowed regulatory agencies to impose civil money penalties on lenders that have a "pattern or practice" of violating flood insurance requirements; (3) allowed institutions to force-place flood insurance coverage when loans are found to lack sufficient coverage; (4) provided stronger notification requirements for properties in the SFHA; (5) made the MPR applicable to properties in the SFHA whose mortgages are purchased by Fannie Mae or Freddie Mac; and (6) made lenders regulated by the Farm Credit Administration responsible for monitoring and enforcing the MPR with respect to their borrowers.[20]

The Biggert-Waters Flood Insurance Reform Act of 2012 and the Homeowners Flood Insurance Affordability Act of 2014

The Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters) and the Homeowners Flood Insurance Affordability Act of 2014 (HFIAA), along with their implementing regulations, made several changes to the MPR.[21] In an effort to discourage perceived non-compliance by federally regulated lenders and their servicers, Biggert-Waters increased the maximum civil monetary penalty amount that regulators could impose per flood violation from $350 to $2,000 and eliminated the $100,000 limit they could assess on a lender in a given year.

Biggert-Waters also updated escrow provisions requiring lenders to escrow borrowers' flood insurance premiums and fees for all loans made, increased, extended, or renewed after January 1, 2016 (unless a specific exception applies, such as for small lenders).[22] HFIAA expanded on this, requiring lenders to notify all borrowers with loans outstanding as of January 1, 2016 of the option to escrow flood insurance costs.

Biggert-Waters revised the rules on force-placement, allowing lenders to initiate policies as soon as a flood coverage lapses or is found to be insufficient and charge borrowers for those costs. If a lender force-places coverage by mistake, however, the law requires them to terminate the policy and refund borrowers for premiums and fees paid during the period of duplicate coverage. To reduce premium costs, HFIAA exempts from the MPR detached structures that do not function as a residence, such as a garage or tool shed. Additionally, Biggert-Waters instructed lenders to accept certain private flood insurance policies to satisfy the MPR applicable to federally-backed mortgages.[23]

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[19] The question of compliance with the MPR remains an ongoing debate, even after the 1994 reforms. As noted earlier, this brief is focused exclusively on the early objectives of the MPR and the mandate's overall efficacy in achieving them, and not on the question of compliance.

[20] The Act also increased coverage limits on the NFIP's residential policies from $185,000 for buildings and $60,000 for contents to $250,000 and $100,000, respectively. These coverage limits have not been raised or adjusted for inflation. They remain in place today, 25 years after they were enacted.

[21] See: https://consumercomplianceoutlook.org/2015/third-fourth-quarter/agencies-issue-final-rule-for-new-flood-insurance-requirements/.

[22] Small lenders are those with less than $1 billion in total assets.

[23] See: https://www.fdic.gov/news/news/financial/2019/fil19008.html.

4. Is the MPR Meeting Congress' Original Goals?

We return now to Congress' overarching goals for the NFIP and a discussion of the MPR's contribution today to achieving those goals.

4.1 Goal 1: Reduce flood damages through adoption of NFIP-mandated floodplain management regulations in participating communities.

The MPR has been successful in stimulating community enrollment in the NFIP. This has led to widespread adoption of the minimum NFIP floodplain regulations, which require new construction to be at or above the estimated base flood elevation (the stage elevation for a 1% annual chance flood). No doubt this land use requirement has reduced flood damages relative to what they might have been without the regulations. However, there are limits to the ability of these NFIP-required regulations to continue to reduce flood damages.

First, the current regulations apply only to new construction, and do not address properties that predate a community's enrollment in the NFIP. These older properties represent a disproportionate share of the claims paid by the program. When the NFIP was created, there had been an expectation that these buildings would be retrofitted or removed over time. Under current NFIP regulations, a property has to come into compliance with floodplain regulations when flood damages result in a loss of more than 50% of its market value or it is retrofitted at greater than 50% of its value. These triggers have not led to either the pace or the extent of retrofitting or removal from the regulatory floodplain that was anticipated. Since the NFIP must continue to provide coverage to these properties, owners can continue to rebuild after smaller events without adopting any mitigation measures.

Second, the 1% line defines the geographic extent of the NFIP-required land use and building regulations. This means that regulation beyond that line is implemented at the discretion of the local community. This is rarely done, even though there can be significant flood damages outside the SFHA boundary.

Finally, regulations are based on an estimation of the stage associated with the 1% chance flood event at the time the original mapping analysis is undertaken. However, in many places flood hazards are increasing rapidly due to changing precipitation patterns, increases in impervious cover, sea level rise, erosion, and/or subsidence (Jones et al. 2006; Rath et al. 2018).[24] This means that in places where the flood hazard is rapidly increasing, the NFIP-required regulations are outdated almost as soon as they are adopted.

Addressing these limitations could be done through a reimagined MPR, but likely will require broader policy changes. For instance, the current MPR line is based on the probability of one return-interval; this could be altered to reflect instead some measure of expected damages, perhaps drawing on current

[24] Beyond the stringency of the regulations, there have been several papers and reports written on the choice of the 1% annual chance standard and its adequacy, which we do not rehash here (see, as just a few examples: FEMA 1983; ASFPM Foundation 2004; Highfield et al. 2013).

rating reform efforts. These same analyses could also be used to identify areas of high flood risk to inform new and cost-effective flood risk reduction programs adopted by communities in partnership with FEMA. Looking ahead, reducing flood damages will require new forms of intergovernmental cooperation and cannot be achieved solely by modifications to or a redesign of the MPR.

4.2 Goal 2: Limit federal disaster aid by lowering flood damages and making insurance the primary tool for financial recovery.

An early stated objective of both the NFIP and the MPR was to reduce the pressure for any increases in federal disaster aid by covering property losses through insurance. Historically and today, the majority of federal disaster expenditures are actually not for damages that could have been insured through the NFIP. The vast majority of federal assistance is provided to state and local governments, not households. FEMA assistance to households accounts for only about 20-25% of the agency's disaster relief spending (Lingle 2017; Lingle 2018). Individual assistance grants are capped at an inflation-adjusted amount (the FY 2019 cap was set at $34,900), but the average recipient typically only receives about $5,000 to $6,000. And even then, less than half of these funds are provided for home repairs; most is provided for temporary housing needs and other disaster related expenses such as transportation or medical expenses (Lingle 2017). A 2006 analysis found that insurance take-up rates were not statistically significant in predicting federal disaster aid expenditures (Dixon et al. 2006). This suggests that if individuals who are not now required to purchase insurance were to buy it, it would only minimally reduce federal aid.

The total amount of federal disaster assistance provided to individuals and households likely will remain a small share of total federal aid spending. There has been recent pressure, however, to expand it. For example, the Disaster Recovery Reform Act of 2018 directed FEMA to remove maximum award limits for certain types of individual assistance including temporary housing and establish separate limits for "Housing Repair and Replacement Assistance" and "Other Needs Assistance."[25] It thus seems that increased take up of insurance might blunt pressure for expanding individual disaster aid but will have a limited effect on total aid expenditures.

4.3 Goal 3: Provide a more reliable and comprehensive mechanism to help survivors recover from flood losses.

There is no doubt that those with insurance, particularly low and middle-income households without enough savings to fully fund rebuilding, recover better and faster than those without insurance (Kousky 2019). The MPR has been effective in expanding the number of households with flood insurance. But there are many properties located in the SFHA that are exempt from the MPR and flood risk extends beyond the SFHA boundary, contributing to a large flood insurance gap in the U.S.

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[25] See: https://www.fema.gov/media-library/assets/documents/177489. The caps remain on repair and construction grants.

According to the U.S. Census, among the approximately 119 million occupied housing units in the U.S., 41% are occupied by homeowners with a mortgage, 23% by homeowners with no mortgage, and 36% by renters. Assuming these percentages hold within the SFHA, then just under 60% of households—as renters or homeowners without mortgages—are not required to purchase flood insurance (note, however, that landlords may be required to insure if they have a loan subject to MPR). FEMA estimates are of a similar magnitude: nationwide FEMA estimates there are approximately 5.02 million households in the SFHA with roughly 1.76 million of those holding a mortgage (FEMA 2018). This suggests that the MPR only applies to roughly 35% of households living in the SFHA, and does not address more than 3 million households in these high hazard areas.

As noted several times already, the MPR also only applies to properties located within the SFHA, but flood risk extends far beyond the 1% annual chance floodplain due to flood events occurring that are greater than the 1% annual chance event, stormwater flooding not captured on FEMA maps, or certain FIRMs and their SFHA designations reflecting outdated data.

Homeowners not subject to the MPR could still purchase flood insurance voluntarily, but very few do. This could be due to lack of awareness of the risk, lack of funds to pay for flood insurance, or misunderstandings about insurance, among other reasons.[26] One commonly discussed contributing factor is that the SFHA boundary line could lead homeowners to believe they are not at risk if they reside outside the 1% annual chance floodplain. This misunderstanding may be reinforced by the absence of flood related land use regulations on development beyond the SFHA boundary and by an MPR requirement that only applies inside the SFHA.

Beyond the many households the MPR does not apply to, it also requires at most the maximum coverage amount that the NFIP offers under statute: $250,000 for one-to-four dwelling residential structures. This was not a major concern in 1994 when Congress last updated this limit and the median home value was $35,700. However, even as home values have risen in the past 25 years (the median home value as of March 2019 was $302,700) the statutory limits on NFIP coverage have not increased.[27] More affluent property owners, however, can often purchase an “excess flood policy” on the private market that provides coverage beyond the NFIP cap.

Expanding purchase of flood insurance beyond what is required by the current design of the MPR could be achieved through many different approaches. Reform of the MPR itself could be considered, ranging from expanding its reach to eliminating it to altering the criteria for mandatory purchase, such as basing it around property-level expected damages instead of the boundary of the modeled 1% annual chance event. Broader risk communication could be developed to try to motivate purchase of flood insurance. Alternative policy options, from opt-out insurance designs to mobile purchasing are all possibilities.[28]

[26] For more discussion on these points, see: Kunreuther and Pauly (2013) and Kousky (2018).
[27] Home value estimates include the value of the land and structure and are taken from the U.S. Census, available online here: https://www.census.gov/construction/nrs/pdf/uspricemon.pdf.
[28] For more ideas on expanding take-up, see Kousky et al. (2019).

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