CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

May 17, 2010

H.R. 5114
Flood Insurance Reform Priorities Act of 2010

As ordered reported by the House Committee on Financial Services on April 27, 2010

SUMMARY

H.R. 5114 would authorize the National Flood Insurance Program (NFIP) of the Federal Emergency Management Agency (FEMA) to enter into and renew flood insurance policies through fiscal year 2015. Under current law, that authority will expire at the end of May 2010. In addition, the legislation would make several changes to the NFIP, which would increase premium income. Under both current law and under this legislation, CBO estimates that the NFIP could continue to make timely payments on valid flood insurance claims until the program's remaining authority to borrow from the Treasury is exhausted. Because provisions affecting premium income would have a minimal effect prior to the time the program exhausts the remaining borrowing authority (which, CBO estimates, would occur in 2013), we estimate that those changes would have no net effect on direct spending over the next 10 years.

By raising certain civil penalties on lending institutions, CBO estimates that enacting the bill would increase revenues by about $1 million per year. Pay-as-you-go procedures apply because enacting the legislation would affect revenues.

The legislation also would authorize the appropriation of $476 million over the 2011-2015 period, and $5 million in 2016, for mitigation and outreach programs and to establish the Office of Flood Insurance Advocate. The bill also would direct FEMA and the Government Accountability Office (GAO) to undertake several studies and issue reports on the NFIP. CBO estimates that implementing those provisions would increase spending by about $378 million over the next five years, assuming appropriation of the necessary funds.

CBO estimates that the changes made to the NFIP by H.R. 5114 would yield additional premium income of $2.8 billion for insurance policies that FEMA can offer under current law. However, CBO estimates that those receipts would be spent to pay insurance claims expected under current law, resulting in no net change to direct spending over the 2011-2020 period.

H.R. 5114 would impose an intergovernmental and private-sector mandate, as defined in the Unfunded Mandates Reform Act (UMRA), on public and private mortgage lenders. Because the mandate would require small changes in existing disclosure requirements, CBO expects that the cost to comply with the mandate would be small and fall well below the annual thresholds established in UMRA for intergovernmental and private-sector mandates ($70 million and $141 million in 2010, respectively, adjusted annually for inflation)

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 5114 is shown in the following table. The costs of this legislation fall within budget function 450 (community and regional development).

	By Fiscal Year, in Millions of Dollars											
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2011-2015	2011-2020
CHANGES IN REVENUES												
Estimated Revenues	1	1	1	1	1	1	1	1	1	1	5	10
CHANGES IN SPENDING SUBJECT TO APPROPRIATION												
Outreach Grants												
Authorization Level	50	50	50	50	50	0	0	0	0	0	250	250
Estimated Outlays	22	50	50	50	50	28	0	0	0	0	222	250
SRL Mitigation Pilot Program												
Authorization Level	40	40	40	40	40	0	0	0	0	0	200	200
Estimated Outlays	8	24	40	40	40	32	16	0	0	0	152	200
Office of Flood Insurance Advocate												
Authorization Level	5	5	5	5	5	5	0	0	0	0	25	30
Estimated Outlays	3	5	5	5	5	5	2	0	0	0	23	30
Studies and Reports												
Estimated Authorization Level	1	0	0	0	0	0	0	0	0	0	1	1
Estimated Outlays	1	0	0	0	0	0	0	0	0	0	1	1
Total Changes												
Estimated Authorization Level	96	95	95	95	95	5	0	0	0	0	476	481
Estimated Outlays	30	71	87	95	95	69	26	8	0	0	378	481

Note: SRL = Severe Repetitive Loss.

For this estimate, CBO assumes that H.R. 5114 will be enacted by the end of fiscal year 2010 and that amounts specified and estimated to be necessary will be appropriated for each year.

BASIS OF ESTIMATE

Background

Authority to Underwrite Coverage. The Congress established the NFIP to provide flood insurance coverage to property owners located in communities that adopt minimum guidelines for floodplain management and enforce building codes designed to minimize future flood damages. The purchase of flood insurance is mandatory for properties located in an area having at least a 1 percent chance of being flooded in any year (such an area is known as a Special Flood Hazard Area, or SFHA) and financed by a federally regulated lending institution, government-sponsored enterprise for housing, or federal lender. Under current law, FEMA is authorized to underwrite the sale and renewal of flood insurance through May 31, 2010. However, following budget rules pertaining to mandatory programs, CBO's baseline projections of future federal spending assume that the NFIP will remain authorized indefinitely. Relative to that baseline, extending the program by this or other legislation would have no effect on the federal budget.

Subsidized Premiums. Under current law, FEMA charges premium rates below the amount necessary to offset the expected cost (also known as the full-risk or actuarial cost) for properties built before a community's flood insurance rate map (FIRM) was completed (or before 1975, whichever is later). Those properties, which make up about 20 percent of all NFIP policies, are collectively known as pre-FIRM properties. FEMA estimates the average premium discount for pre-FIRM properties is about 60 percent. Some post-FIRM properties also receive a discounted premium under current law, but they are few in number (less than 1 percent of all properties) relative to pre-FIRM properties. It is unclear whether other post-FIRM properties also have subsidized premiums not specified in law[1]; however, for this estimate, CBO assumes that all actuarially based premium rates calculated by FEMA generate a sufficient amount of income to cover expected claims for those properties.

Ability to Pay Claims and Other Expenses. The Congress established the National Flood Insurance Fund (NFIF) as the sole source of funding to pay claims and other expenses associated with the NFIP. The NFIF is credited with amounts received from advance appropriations, premium and fee income, interest earned on fund balances (if any), and amounts borrowed from the Treasury (up to the statutory limit of $20.775 billion).

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1. See Congressional Budget Office, *The National Flood Insurance Program: Factors Affecting Actuarial Soundness* (November 2009).

Expenses of the program may only be paid to the extent that those sources of funds are available. Once balances in the fund are exhausted, property owners with valid claims would have to wait until sufficient resources became available to pay them.

In most years since the NFIP began, advance appropriations along with premium and fee income have been sufficient to either cover the annual expenses of the NFIP or generate a surplus. However, because of the large subsidy that exists for many policies, CBO estimates that the program will—on average—have greater annual expenditures than income, necessitating the use of its authority to borrow from the Treasury. Mostly due to the large claims covered by the program following the 2005 hurricane season, the NFIP has a current outstanding debt of $18.75 billion to the Treasury as of May 2010. Based on its estimate of annual subsidies, CBO expects that the NFIP will not repay this amount and will exhaust its remaining borrowing authority over the next few years. At that point, net spending for the program will be zero—payments would be limited to amounts deposited into the NFIF through premium and fee income, and additional borrowing would not be available. Thus, expenses exceeding NFIF deposits in a given year would be paid at a later date upon collection of future receipts.

Direct Spending and Revenues

Civil Penalties. Section 16 would increase the civil penalty from $350 to $2,000 for lenders that do not enforce the NFIP purchase and notification requirements for certain mortgagors. The maximum penalties that could be levied against institutions in one year would increase from $100,000 to $1 million, although no limit would exist for institutions fined at the maximum level in at least three of the five previous years. Penalty collections are recorded in the budget as revenues. CBO estimates that the increased collections of civil penalties would total about $1 million a year. The amounts collected would be credited to the National Flood Mitigation Fund and could be spent if appropriated.

Other Changes to the NFIP. As of January 2010, the NFIP had approximately 5.6 million policies in force, with a total insured exposure of $1.2 trillion. Policyholders pay about $3.2 billion in premiums for that coverage annually. H.R. 5114 would make several changes that would affect premium growth and exposure of the NFIP in the future. Those changes include:

- Increasing premiums for some pre-FIRM policyholders;

- Delaying the mandatory purchase requirement for properties recently designated as being within a SFHA, and providing temporary discounted premiums for such properties;

- Increasing the deductible carried by some policyholders;

- Increasing the limit on average annual premium growth;
- Increasing the maximum coverage for structure and contents; and
- Introducing new lines of insurance for additional living expenses and business interruption.

Overall, CBO estimates that those changes would increase net income to the NFIP by $3.2 billion over the next 10 years. While this additional income would improve the financial status of the NFIP, it would not fully offset the existing subsidy built into the program under current law. Therefore, CBO assumes that any additional premium collected as a result of this legislation would be spent to pay for claims and other costs, resulting in no net change in direct spending.

Premium Increases for Some Pre-FIRM Properties. Section 5 would direct FEMA to increase flood insurance premiums for pre-FIRM properties that are: nonresidential or not the primary residence of either the owner or a tenant (for example, vacation homes), and those purchased after enactment. Three years following enactment, all policyholders fitting such categories would begin receiving premium increases of 20 percent per year until the amount collected each year covers the full cost of the insurance. New policies purchased after that three-year period would immediately pay the full-cost premium. Based on information from FEMA, CBO estimates that more than 400,000 properties would be subject to such rate increases under the bill. Owners of some of those properties would either drop their policies or reduce their coverage in response to the premium increases. However, CBO expects that any decrease in premium resulting from a reduction in coverage would be more than offset by increased collections from properties that remain in the program. Additionally, by reducing the coverage of pre-FIRM properties in the program, the NFIP would save the cost of paying claims on those subsidized policies, enhancing the financial status of the program.

CBO estimates that implementing the premium increases outlined in the bill would raise income by about $2.8 billion over the 2011-2020 period. Subsidized policyholders that drop flood insurance coverage in response to the premium increases would reduce net program costs by an average of $50 million (mostly over the 2014-2020 period) a year over the next 10 years, CBO estimates.

Delay in Mandatory Purchase Requirement and Temporary Discounted Premiums. Section 6 of H.R. 5114 would delay the requirement to purchase flood insurance for some property owners. Owners required under current law to purchase coverage because their property was placed into an SFHA due to changes made by a flood insurance rate map that became effective later than August 31, 2008, would no longer be required to purchase a policy for five years after the effective date of the map. To be eligible, the property also must be located within a community that has developed flood evacuation, outreach, and communication plans. FEMA would not be authorized to provide refunds to policyholders no longer required to purchase flood insurance.

CBO estimates that reduced coverage among post-FIRM policyholders as a result of this provision would have no net effect on the financial status of the program, as any reduction in premium income would be—on average—roughly offset by a reduction in claims payments. The reduction in premium income from pre-FIRM policyholders electing to drop coverage would be less than the cost of those subsidized properties, improving the financial status of the NFIP by the amount of the subsidy.

Section 7 would direct FEMA to charge discounted premiums for properties relocated into a SFHA by a recently issued FIRM. Discounts would be as high as 80 percent immediately following the five-year delay specified by section 6 of the bill and would gradually phase out over a second five-year period. (Presumably, policyholders that voluntarily elect coverage during the initial five-year period prior to the mandatory purchase requirement also would receive discounted premiums, although this would be at the discretion of FEMA.) This provision would create a new class of subsidized policies within the NFIP. Based on the estimated number of properties that have been and would be placed into an SFHA, CBO estimates that this new subsidy would amount to about $160 million over the next 10 years, worsening the financial status of the program by that amount.

Increase in the Minimum Policy Deductible. Section 14 would set the minimum deductible for structural coverage at $750 for post-FIRM properties ($1,000 for policies with coverage above $100,000) and $1,500 for pre-FIRM properties ($2,000 for policies with coverage above $100,000). Under current law, FEMA has the discretion to set the minimum deductible for flood insurance policies. As of May 2010, the standard deductible is $1,000 for post-FIRM properties and $2,000 for pre-FIRM properties. CBO does not expect that this legislation would alter the current standard deductibles because those amounts are greater than the minimums specified by the bill. However, under current regulations, pre-FIRM policyholders may reduce the standard deductible by $1,000 in exchange for a higher premium. Under the bill, those policyholders would no longer be able to take such action because that deductible would fall below the minimum required for pre-FIRM properties. Based on information from FEMA, CBO estimates that 250,000 policies (most of which are for pre-FIRM properties) would carry a higher deductible in the next few years as a result of this bill. Because the probability of payment is higher at lower loss levels, we estimate that this increase would reduce claims payments by less than 5 percent.

Increase in Average Annual Limit on Premium Growth. Section 8 would authorize the NFIP to increase premiums within a specific rate category by an average of up to 20 percent per year. Under current law, the limit is 10 percent. While FEMA has recently increased premiums at or near the current maximum level, CBO estimates that raising this limit would not result in significant increases for the largest risk categories of post-FIRM properties. (Increases for subsidized policies would be affected by other provisions of the bill.)

Increase in Maximum Coverage and New Lines of Insurance. Sections 4 and 12 would increase the total amount of flood insurance coverage available for a residential property from $350,000 ($250,000 for structures and $100,000 for contents) to $470,000 ($335,000 for structures and $135,000 for contents), and for a commercial property from $1 million ($500,000 for structures and $500,000 for contents) to at least $1.3 million ($670,000 for structures and $670,000 for contents). For commercial rental properties, maximum coverage would be determined by the number of dwelling units contained in the property. In addition, the legislation would direct FEMA to include coverage of up to $1,000 of living expenses in all future policies. Optional coverage would be available for living expense in excess of $1,000 and partial or total business interruption.

Under the bill, the increased coverage limits and new lines of insurance would be offered to policyholders at the full-cost premium. While CBO cannot estimate the total amount of new insurance that would be purchased as a result of those provisions, we expect that any additional coverage would increase premium receipts to the federal government and would—on average—be roughly offset by additional claims payments and other expenses.

Spending Subject to Appropriation

CBO estimates that implementing H.R. 5114 would cost $378 million over the 2011-2015 period, subject to appropriation of the specified amounts.

Outreach Grants. Section 18 would authorize the appropriation of $50 million a year over the 2011-2015 period for FEMA to encourage and facilitate the purchase of flood insurance coverage by property owners and renters and to increase public awareness of flood-risk reduction. At least half of the funding provided would be used for grants to local governments that participate in the NFIP for those purposes. Remaining funds would be used by FEMA to directly provide outreach and educational activities. Assuming appropriation of the specified amounts, CBO estimates that implementing this program would cost $222 million over the 2011-2015 period.

Severe Repetitive Loss (SRL) Mitigation Pilot Program. Section 3 would authorize FEMA to use up to $40 million a year from the NFIF to extend the SRL Mitigation Pilot Program through 2015. The program provides grants for up to 75 percent (90 percent for projects in states or Indian tribes with approved enhanced mitigation plans) of the cost of projects that reduce future damage to NFIP-insured SRL properties (properties that have received claims payments of greater than $5,000 at least four times in its history or have received at least two payments that together exceed the market value of the structure). In 2010, the Congress provided $70 million though the NFIF for this purpose (see Public Law 111-83). CBO estimates that implementing this section would cost $132 million over the 2011-2015 period.

Over the next 10 years, some or all of the costs of the mitigation program may be offset by lower claims payments, depending on the effectiveness of the mitigation efforts. Savings from lower claims payments cannot be attributed directly to this legislation, however, because the size and duration of any mitigation program would depend on amounts provided by future appropriations acts.

Office of Flood Insurance Advocate. Section 22 would authorize FEMA to use up to $5 million a year over the 2011-2016 period to fund activities of a new Office of Flood Insurance Advocate. Funding would come from the NFIF, subject to future appropriation action. The office would assist in resolving conflicts between policyholders and the NFIP and would propose changes in the administrative process to prevent future conflicts. CBO estimates that operations of the new office would cost $23 million over the next five years.

Studies and Reports. H.R. 5114 would direct FEMA and GAO to conduct studies and issue reports on a number of topics, including expanding the mandatory flood insurance purchase requirement to all properties located in a SFHA, methods to increase participation among low-income families, the ability of the program to repay its current debt, and short- and long-term effects of this legislation on the financial soundness of the program. CBO estimates that those activities, which would conclude within one year of enactment of H.R. 5114, would cost about $1 million in 2011, assuming appropriation of the necessary funds.

PAY-AS-YOU-GO CONSIDERATIONS

The Statutory Pay-As-You-Go Act of 2010 establishes budget reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays and revenues that are subject to those pay-as-you-go procedures are shown in the following table.

CBO Estimate of Pay-As-You-Go Effects for H.R. 5114, as ordered reported by the House Committee on Financial Services on April 27, 2010

	By Fiscal Year, in Millions of Dollars												
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2010-2015	2010-2020
NET INCREASE OR DECREASE (-) IN THE DEFICIT													
Statutory Pay-As-You-Go Impact	0	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-5	-10

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 5114 would impose an intergovernmental and private-sector mandate, as defined in UMRA, on public and private mortgage lenders. Under current law, mortgage lenders who make federally related mortgages, as defined in 12 U.S.C. 2602, are required to provide a good-faith estimate of the amount or range of charges the borrower is likely to incur for specific settlement services. The bill would require such mortgage lenders to include specific information about the availability of flood insurance in each good-faith estimate. To the extent that state agencies issue loans or other credit instruments that would be subject to the requirements of the Real Estate Settlement Procedures Act, the bill would impose intergovernmental mandates.

The mandate would require small changes in existing disclosure requirements. Consequently, CBO estimates that the cost of the mandate to public and private mortgage lenders would be small and fall well below the annual thresholds established in UMRA for intergovernmental and private-sector mandates ($70 million and $141 million in 2010, respectively, adjusted annually for inflation).

Other Impacts

State, local, and tribal governments would benefit from the authorization of appropriations for mitigation and outreach activities related to flood hazards. Any costs to those governments, including matching funds, would be incurred voluntarily.

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