CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

June 8, 2011

H.R. 1309
Flood Insurance Reform Act of 2011

As ordered reported by the House Committee on Financial Services on May 13, 2011

SUMMARY

H.R. 1309 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 2016. Under current law, that authority will expire at the end of fiscal year 2011.

The legislation also would make a number of changes to the NFIP aimed at improving the financial status of the program. Under both current law and this legislation, the NFIP may borrow an additional $3 billion from the Treasury (the program's current debt stands at $17.8 billion). Assuming a small probability of a rare catastrophic event, CBO expects that this additional borrowing authority will be exhausted in 2014. The changes made by this legislation would reduce the need to borrow from the Treasury—a source of direct spending—by a total of $165 million in 2013 and 2014, CBO estimates. However, because the program would continue to operate with an annual net deficit, reduced borrowing in those years would be offset by increased borrowing in 2015, resulting in no net effect on direct spending over the next 10 years.

CBO also estimates that the changes made by H.R. 1309 would increase net income to the NFIP by $4.2 billion over the 2012-2021 period, improving the financial status of the program by that amount. However, we expect that additional income earned by the program would be used to fulfill existing obligations that would otherwise be delayed under current law, resulting in no net effect on direct spending.

Pay-as-you-go procedures apply because enacting the legislation would affect direct spending. Enacting this legislation would not affect revenues.

H.R. 1309 would authorize a number of other activities, including establishing a Technical Mapping Advisory Council, updating flood maps to incorporate new standards within five years, and issuing several reports on the NFIP. The cost of some of those activities would be offset by fee collections paid by policyholders; however, CBO estimates that other provisions would cost $317 million over the 2012-2016 period, subject to appropriation of the necessary amounts.

H.R. 1309 would impose intergovernmental and private-sector mandates, as defined in the Unfunded Mandates Reform Act (UMRA), on public and private mortgage lenders. Because the mandates would require only small changes in existing industry practice, CBO expects that the cost to comply with the mandates would be small relative to the annual thresholds established in UMRA for intergovernmental and private-sector mandates ($71 million and $142 million in 2011, respectively, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 1309 is shown in Table 1. The costs of this legislation fall within budget function 450 (community and regional development).

Table 1. Changes in Direct Spending and Spending Subject to Appropriation Under H.R. 1309

	By Fiscal Year, in Millions of Dollar						
	2012	2013	2014	2015	2016	2012-2016	2012-2021
CHANGES IN DIRECT SPENDING							
Estimated Budget Authority	0	0	0	0	0	0	0
Estimated Outlays	0	-45	-120	165	0	0	0
CHANGES IN SPENDING SUBJECT TO APPROPRIATION							
New Mapping Standards							
Estimated Authorization Level	0	100	130	135	140	505	750
Estimated Outlays	0	20	66	100	128	314	745
Studies and Reports							
Estimated Authorization Level	1	1	*	*	*	3	4
Estimated Outlays	1	1	*	*	*	3	4
Total Changes							
Estimated Authorization Level	1	101	130	135	140	508	754
Estimated Outlays	1	21	66	100	128	317	749

Note: * = between $0 and $500,000.

BASIS OF ESTIMATE

For this estimate, CBO assumes that the legislation will be enacted by the end of fiscal year 2011 and that amounts estimated to be necessary will be appropriated for each year.

Background

Authority to Underwrite Coverage. The NFIP was established to encourage the purchase of flood insurance by property owners located in communities that adopt minimum guidelines for floodplain management and to enforce building codes designed to mitigate flood damages. Flood insurance coverage is mandatory for properties located within an area designated as 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 is financed by a federally regulated lending institution, a government-sponsored enterprise for housing, or a federal lender. Property owners not receiving financing or coverage from those entities or located outside a SFHA may purchase flood insurance coverage from a private carrier or the NFIP at their discretion. Under current law, FEMA is authorized to underwrite the sale and renewal of flood insurance policies through September 30, 2011.

Subsidized Premiums. Throughout the program's history, FEMA has charged premiums well 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, known as pre-FIRM properties, make up over 20 percent of all NFIP policies. FEMA estimates that pre-FIRM policyholders pay average premiums that are about 40 percent to 45 percent of the full-risk cost. Some post-FIRM properties also receive discounted premiums under current law; however, they are few in number (less than 1 percent of all NFIP policies) relative to pre-FIRM properties. It is unclear whether other property owners receive premium subsidies not directly specified in law.[1] For this estimate, CBO assumes that all policies not directly receiving subsidies will generate a sufficient amount of income to cover expected claims and related expenses over time.

Ability to Pay Claims and Other Expenses. The National Flood Insurance Fund (NFIF) is the sole source of claims payments and other expenses associated with the NFIP. Under current law, the fund is credited with premium and fee receipts from policyholders, annual appropriations, interest earned on fund balances, and amounts borrowed from the Treasury. As of February 2011, the NFIP insured approximately 5.6 million policies with written annual premiums in force of $3.4 billion. For fiscal year 2011, the Congress provided the fund with $169 million in appropriations, offset by an equivalent amount of fee collections from policyholders (see Public Law 112-10). No interest income or borrowing is expected to occur this year, CBO estimates.

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

The majority of the NFIP's expenses consist of payments for insured claims resulting from outstanding coverage in force, which currently stands at about $1.2 trillion. FEMA estimates that claims payments in 2011 will total about 43.5 percent of premium income, based on the historical experience of policies and coverage amounts currently insured by the program. Actual expenses for insured claims, however, have varied widely by year, ranging from less than 10 percent of premium to almost 800 percent of premium (based on calendar-year totals).

In most years, annual appropriations along with premium and fee income have been sufficient to cover the annual expenses of the NFIP. Prior to 2005, it was occasionally necessary for the program to borrow from the Treasury to meet expenses during greater-than-average-loss years; however, that borrowing was relatively small (less than $1 billion) and was repaid with interest. Nonetheless, because of the large subsidy that exists for many policies, CBO estimates that the program will—on average—have greater annual expenses than revenue. This differential became apparent in the aftermath of Hurricanes Katrina, Rita, and Wilma in 2005. Because of the severe and widespread damages experienced during those storms, the program borrowed an unprecedented $16.7 billion in fiscal year 2006 to cover claims and interest expenses. NFIP's current debt to the Treasury stands at $17.8 billion. It is highly unlikely that the program will have sufficient income to repay those borrowed funds within the next 10 years.

Assuming actuarial-level losses[2] in 2012 and beyond, the NFIP will need to continue borrowing from the Treasury until its line of credit (currently set at $20.7 billion) is exhausted, which CBO estimates will occur in 2014 under current law. At that point, because expenses of the program may only be paid to the extent that resources in the NFIF are available, net spending would be zero. Payments for claims and other expenses would be delayed until sufficient resources became available to the NFIF from premium and fee income.

Direct Spending

CBO estimates that enacting H.R. 1309 would have no net impact on direct spending over the 2012-2016 or 2012-2021 periods.

Section 2 would provide FEMA with the authority to continue selling and renewing policies through fiscal year 2016. While this authority would otherwise expire at the end of the current fiscal year, the program is assumed to continue in the CBO baseline, consistent with the rules governing baseline projections for mandatory programs. Thus, extending the NFIP under this legislation would have no effect on direct spending relative to the baseline.

2. Actuarial-level losses take into account the full range of possible losses, including rare catastrophic events like Hurricane Katrina.

In addition to extending the NFIP, H.R. 1309 would make a number of changes to the program. The two changes that would affect direct spending are:

- Premium increases for some pre-FIRM policyholders; and
- Temporary discounted premiums for certain properties located in such areas.

Other changes that CBO estimates would affect the amount of flood insurance coverage and the amount of premiums collected but would not affect net direct spending include:

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

The estimated aggregate effects of those changes are listed in Table 2.

Table 2. Change in Net Income to the NFIP Under H.R. 1309 Over Selected Time Periods

	By Fiscal Year, In Millions of Dollars		
	2012-2014	2012-2016	2012-2021
Income			
Premium Increases for Some Pre-FIRMs	222	936	5,364
Temporary Discounted Premiums	-38	-84	-180
Total Changes to Revenues	184	852	5,184
Expenses			
Increased Payments to WYO Companies	56	259	1,584
Reduced Claims Due to Dropped Policies	-37	-125	-564
Total Changes to Expenses	19	134	1,020
Change in Net Income [a]	165	718	4,164
Cumulative Net Effect on Direct Spending	-165	0	0

Note: FIRM = Flood Insurance Rate Map; WYO = Write-Your-Own.

a. After the NFIP's borrowing authority has been exhausted, changes in net income are reflected as a corresponding increase or decrease in the delay in claims payments expected to be experienced by NFIP policyholders and thus do not affect direct spending.

Overall, CBO estimates that changes made by H.R. 1309 would increase net income to the NFIP by $165 million through 2014. CBO expects that the flood insurance program will not have exhausted its remaining borrowing authority during this period. Therefore, additional net income earned by the NFIP over that period would reduce expected borrowing from the Treasury—a source of direct spending. However, assuming annual program deficits,[3] CBO estimates that any reduction in direct spending generated by lower borrowing in those years will be offset by increased direct spending from additional borrowing in 2015, resulting in no net effect on the federal budget over the next 10 years.

After 2014, the changes made by H.R. 1309 would not affect net direct spending because CBO expects that any additional income earned by the program would be used to fulfill obligations (mostly claims payments) that would otherwise be delayed. However, enactment of the legislation would improve the financial status of the program by reducing this expected "backlog" of unfulfilled payments. Under current law, CBO estimates that delayed payments would total $3.6 billion by 2016 and $12.6 billion by 2021. Under H.R. 1309, we estimate that the "backlog" would total $2.9 billion in 2016 and $8.4 billion in 2021, a reduction of about $700 million and $4.2 billion, respectively.

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 nonprimary residences; residences sold to new owners; or severe repetitive loss properties (defined as residences with at least four paid claims greater than $5,000 or with two paid claims that cumulatively exceed the market value of the house). One year after enactment, all policyholders of properties fitting such categories would begin receiving premium increases of 20 percent per year[4] until the amount collected each year covers the full cost of the insurance. New policies that fit such criteria one year after enactment would immediately pay the full-risk premium.

Based on housing data and current policy information obtained from FEMA, about 355,000 policies would initially be subject to such premium increases under the bill, CBO estimates. Those policyholders currently pay an average premium of about $1,174 per year. Once subsidies are completely phased out, we expect that annual premiums for those policies would be, on average, about 2¼ times greater than premium that would otherwise be charged under current law. While some policyholders would reduce or eliminate coverage as a result of those increases, CBO estimates that any resulting decrease in premium receipts would be more than offset by increases from properties that remain in the program.

3. CBO estimates that changes made by H.R. 1309 would reduce the aggregate subsidy built into premiums under current law by over 50 percent by 2021; however, because the legislation would not completely eliminate subsidies for all policies, we estimate that the program would continue to operate under an annual deficit.

4. The 20 percent would include some increase that FEMA would have applied to the policy under current law; thus the actual increase in per policy premium attributable to this legislation would be less than 20 percent.

Additional premium receipts from pre-FIRM policyholders would total $936 million over the 2012-2016 period and about $5.4 billion over the next 10 years, CBO estimates. Under current agreements, Write-Your-Own (WYO) companies would receive a portion of this additional premium (about 30 percent), reflected in Table 2 as an increase in expenses. Subsidized policyholders that drop out of the NFIP would save the cost of paying claims on those policies, resulting in a decrease in expenses. Altogether, CBO estimates that implementing the premium increases outlined in the legislation would increase net income to the NFIP by $775 million over the next five years and by about $4.3 billion over the 2012-2021 period.

Temporary Discounted Premiums. Section 5 would direct FEMA to charge subsidized premiums for certain properties newly mapped into a SFHA after October 1, 2008. Under the bill, owners of primary residences in new SFHAs would be charged 50 percent of the premium that applies under current law during the first year following the map's effective date (or, in the case of properties eligible for a Preferred Risk Policy Extension,[5] during the first year following the expiration of that extension). The legislation requires FEMA, in each successive year, to increase rates by 20 percent until the premium is equal to the amount that otherwise would be charged in the absence of this section.

That provision would create a new class of subsidized policies within the NFIP. The cost of the subsidy would be somewhat mitigated by the delay in the mandatory purchase requirement under section 3 of the bill.[6] According to the American Institutes for Research, voluntary take-up of flood insurance within an SFHA is about 20 percent, compared to 75 percent to 80 percent if such coverage were mandatory. Because fewer property owners would purchase subsidized flood insurance if coverage is voluntary, the overall cost of the new subsidy would be lower than if coverage were mandatory.

Based on the estimated number of properties that have been or would be placed into a SFHA, CBO estimates that implementing this new subsidy would reduce premium income to the NFIP by about $180 million over the next 10 years. The overall effect of this provision on net income would be somewhat less (about $125 million) because it also would result in reduced payments to WYO companies.

5. For properties newly mapped into a SFHA after October 1, 2008, that previously qualified for a Preferred Risk Policy (PRP) premium (i.e., could not have two or more claims or disaster relief payments of $1,000 or more, or three losses or payments of any kind), FEMA currently offers a discount equal to the premium the policyholder would have paid and the PRP premium. That discount is available for two years. For properties mapped into a SFHA after October 1, 2008, and before January 1, 2011, the discounted premium is available for the two renewals between January 1, 2011, and December 31, 2012.

6. Section 3 would delay the requirement to purchase flood insurance for some property owners. Upon receiving a request from a local government, property owners placed into a SFHA because of changes to a FIRM would not immediately be required to purchase flood insurance. This delay in the mandatory purchase requirement would last for a period of time to be determined by FEMA, but no longer than three years.

Increase in the Minimum Policy Deductible. Section 4 would set the minimum deductible for structural coverage at $2,000 for subsidized properties and $1,000 for nonsubsidized properties. Under current law, FEMA has the discretion to set a minimum deductible. For the current policy year (which began October 2010), the standard deductible is $2,000 for most subsidized properties and $1,000 for nonsubsidized properties; however, pre-FIRM policyholders may reduce that deductible by $1,000 in exchange for a higher premium. Under the bill, CBO expects that the standard deductible would remain unchanged but that subsidized policyholders would no longer be able to reduce their deductible. Based on information from FEMA, CBO estimates that about 250,000 policies (mostly for pre-FIRM properties) would carry a higher deductible as a result of this provision, which would reduce average insured claims for those properties by between 5 percent and 10 percent. However, increasing the deductible also would lower premium receipts by an equivalent amount. As such, CBO estimates that implementing this provision would not affect net income to the NFIP and would have no effect on the federal budget.

Increase in Average Annual Limit on Premium Growth. Section 5 would authorize the NFIP to increase premiums within a specific risk category by an average of up to 20 percent per year. Under current law, the limit is 10 percent. Based on historical experience, CBO assumes that raising this limit would not result in consistent premium increases of more than 10 percent for most subsidized policies. (Under both current law and H.R. 1309, actuarially rated policies are assumed to receive premium increases necessary to cover the full cost of the coverage.) Therefore, implementing this provision would have no net effect on the NFIP or the federal budget.

Increase in Maximum Coverage and New Lines of Insurance. Section 4 would adjust the total amount of flood insurance coverage available by increasing the current limit by the level of inflation from the end of fiscal year 1994 to enactment of the legislation. The current limit is $350,000 ($250,000 for structures and $100,000 for contents) for a residential policy and $1 million ($500,000 for structures and $500,000 for contents) for a non-residential policy. CBO estimates that the new coverage limits would be about $520,000 and $1.5 million, respectively. In addition, the legislation would direct FEMA to offer optional coverage of up to $5,000 for living expenses incurred during the loss of use of a personal residence and up to $20,000 for 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-risk premium. For this estimate, CBO did not estimate the total amount of new coverage that would be purchased as a result of those provisions. We expect that any additional coverage would increase premium receipts to the federal government as well as claims payments and other expenses, resulting in no net effect on the federal budget.

Spending Subject to Appropriation

CBO estimates that implementing H.R. 1309 would cost $317 million over the 2012-2016 period and $749 million over the 2012-2021 period, subject to appropriation of the necessary amounts.

Technical Mapping Advisory Council. Section 6 would establish a Technical Mapping Advisory Council (TMAC) to develop and recommend new mapping standards for FIRMs. The council would include representatives from FEMA, the U.S. Geological Survey, the Army Corps of Engineers, other federal agencies, state and local governments, as well as experts from private stakeholder groups. The council would submit the new standards to FEMA and the Congress within 12 months of enactment and would continue to review those standards for four additional years, at which time the council would be terminated.

Under current law, spending for floodplain management activities (which CBO assumes would include operations of the new council) are subject to future appropriation acts. FEMA is authorized to offset those costs by collecting a fee (known as the Federal Policy Fee) from policyholders. As such, CBO estimates that implementing this section would have no net effect on discretionary spending over the next five years.

New Mapping Standards. Section 7 would direct FEMA to implement new standards for FIRMs. Beginning six months after the TMAC issues its initial set of recommendations, FEMA would have five years to update all FIRMs to incorporate the new standards, subject to the availability of appropriated funds. The greatest costs likely would arise from determining the level of protection afforded by decertified levees; however, because the new standards would be based on recommendations made by the TMAC and on findings from studies required in the bill (for example, graduated risk), it is unclear how the new standards and the cost to implement them would differ from those currently in use. Based in part on the projected costs of implementing FEMA's Risk Mapping, Assessment, and Planning program (which would incorporate some of the new standards in this section), CBO estimates implementing this section would cost $314 million over the 2012-2016 period. Because CBO expects the required map updating would continue through 2018 under the bill, we estimate that implementing this section would cost an additional $431 million after 2016. All expenditures would be subject to appropriation of the necessary amounts.

Studies and Reports. H.R. 1309 would direct FEMA and Government Accountability Office (GAO) to conduct studies and issue reports on a number of topics, including limiting the percentage of policies directly managed by FEMA, community-based flood insurance, building codes, varying risk behind levees, privatization of the NFIP, and the financial status and claims-paying ability of the program. Based on the cost of similar studies, CBO estimates that producing the reports required under the legislation would cost about $3 million over the next five years, subject to appropriation of the necessary funds.

Other Discretionary Changes. H.R. 1309 would make a number of other changes to current law, including authorizing FEMA to make flood mitigation grants directly to property owners (under current law, funding is provided through communities), authorizing the use of Community Development Block Grant funds for building code enforcement and flood program outreach, and authorizing the reimbursement of costs incurred by homeowners that obtain a Letter of Map Amendment (LOMA). CBO does not expect that changes made to mitigation or community development grants under the bill would significantly alter the pace of expenditures under either program. Based on information from FEMA, reimbursements of expenses related to LOMAs could total as much as $15 million annually; however, those costs would likely be recouped through increases in premiums or fees paid by policyholders, resulting in no net effect on the federal budget.

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 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. 1309 as ordered reported by the House Committee on Financial Services on May 17, 2011

	By Fiscal Year, in Millions of Dollars												
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2011-2016	2011-2021
	NET INCREASE OR DECREASE (-) IN THE DEFICIT												
Statutory Pay-As-You-Go Impact	0	0	-45	-120	165	0	0	0	0	0	0	0	0

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 1309 would impose intergovernmental and private-sector mandates, as defined in UMRA, on public and private mortgage lenders. Because the mandates would require only small changes in existing industry practice, CBO expects that the cost to comply with the mandates would be small relative to the annual thresholds established in UMRA for intergovernmental and private-sector mandates ($71 million and $142 million in 2011, respectively, adjusted annually for inflation).

Flood Insurance

Current law prohibits lenders from making loans for real estate in areas at high risk for flood damage unless the property is covered by flood insurance. This bill would require lenders to accept flood insurance from a private company if the policy fulfills all federal requirements for flood insurance. Under current law, lenders also are required to purchase flood insurance on behalf of the homeowner if, at any time during the life of a loan, they determine that a homeowner does not have a current policy in place. The bill would require lenders to terminate those policies within 30 days of being notified that the homeowner has purchased another policy. Lenders also would have to refund any premium payments and fees made by the homeowner for the time when both policies were in effect. Based on information from industry sources on current practice, CBO estimates that the cost of complying with those mandates would be small.

Disclosure Requirements

Current law requires mortgage lenders that make federally related mortgages (as defined in title 12, U.S.C. 2602) to provide a good-faith estimate of the amount or range of charges the borrower is likely to incur for specific settlement services. (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 also would impose intergovernmental mandates.) The bill would require such mortgage lenders to include specific information about the availability of flood insurance in each good-faith estimate. 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.

Other Impacts

State, local, and tribal governments would benefit if funds authorized to be appropriated for mitigation and outreach activities related to flood hazards were made available in the future. Any costs to those governments, including matching funds, would be incurred voluntarily.

ESTIMATE PREPARED BY:

Federal Costs: Daniel Hoople
Impact on State, Local, and Tribal Governments: Melissa Merrell
Impact on the Private Sector: Sam Wice

ESTIMATE APPROVED BY:

Theresa Gullo
Deputy Assistant Director for Budget Analysis