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U.S. House Committee on Financial Services
"Preparing for the Storm: Reauthorization of the National Flood Insurance Program"
March 13, 2019

Chairwoman Waters, Ranking Member McHenry and members of the committee,

My name is R.J. Lehmann, and I am director of finance, insurance and trade policy at the R Street Institute, of which I am also a co-founder. R Street is a nonpartisan, nonprofit research organization and our mission is to identify and promote pragmatic, market-oriented solutions to public policy challenges. I appreciate the opportunity to testify and to share our views on potential reforms to the National Flood Insurance Program (NFIP), which has been a core research area for R Street since opening our doors seven years ago.

The NFIP is a textbook example of unintended consequences. It was established to correct a market dislocation, by providing coverage that private insurers would not; to reduce the nation's reliance on post-hoc disaster assistance; to provide incentives for communities to invest in mitigation; and to be self-sustaining. It has not been self-sustaining, as the program has been forced to borrow nearly $40 billion from the U.S. Treasury over the past decade and a half. Disaster spending continues to grow, with more than 90 percent of all federally declared disasters involving floods.[1] While the program has provided incentives for mitigation, these have not gone far enough, and the availability of cheap flood insurance has played a role encouraging people to build in flood-prone regions. The number of Americans living in coastal counties grew by 45 percent from 1970 to 2010 and now comprises more than half the U.S. population.[2] And while the NFIP does continue to fill an important role in insurance markets, its subsidies and mispriced risks distort those markets and discourage the emergence of private alternatives.

R Street is ideologically situated on the political right, but we long have prided ourselves on our willingness to form broad coalitions across the ideological spectrum that enable work with any policymaker or organization who shares our perspectives. In the area of flood insurance, this has been

[1] https://www.downsizinggovernment.org/dhs/fema
[2] http://www.livescience.com/18997-population-coastal-areas-infographic.html

manifest in our status as a founding and active member of the SmarterSafer Coalition, which brings together fellow free-market groups, environmental and conservation advocates, taxpayer advocates, insurance interests, and housing and mitigation experts to advocate for effective and efficient disaster policy. SmarterSafer, represented on this panel by the National Wildlife Federation, advocates reforms to the NFIP to make it fiscally sustainable, to remove incentives to development in flood-prone and environmentally sensitive regions, to invest in mitigation and more accurate mapping, to facilitate consumer choice in flood insurance products and to ensure that property owners and the general public have clear information about flood risks.

Reviewing several of the draft bills the committee will consider, I am heartened that they make significant progress to address several of these priorities. I also hope to highlight a few areas where further reform would be appropriate.

AFFORDABILITY AND SUBSIDIES

The most significant new element introduced in the discussion draft is the proposed demonstration project for means-tested discounted rates. I would like to commend the chairwoman, in particular, for her commitment to this issue. Addressing affordability has been a topic toward which members have paid quite a bit of lip service over the past 15 years, but this is the first substantial proposal to do exactly that.

The bill's demonstration project would extend premium discounts to households making less than 80 percent of an area's median household income, with discounted rates that would be capped at 2 percent of annual area median income. Along with other members of the Smarter Safer Coalition, we have long advocated for affordability provisions to help those who are low income, with means-tested assistance outside of the rate structure. Our view is that vouchers or other forms of direct premium assistance are preferable to discounted rates because they ensure the NFIP continues to receive the appropriate amount of premium.

In looking at the draft bill, I have some concern that the premium caps may not be ideally structured to assist those who truly need it. While the 80 percent threshold may be appropriate in some communities, it may be necessary to add an upper income bound. For example, under this formula, in Loudon County, Virginia, where the median household income tops $134,000, a household making $108,000 a year – nearly double the national median – would be treated as low income. And while the cohort eligible to receive discounts could be too broad, the discounts themselves might be insufficiently generous. To ensure that discounts are useful for low-income homeowners, rather than a single cap calculated as a percentage of area median income, discounted rates should be calculated as a percentage of the policyholder's own household income.

Among the reasons that a means-tested affordability program long has been needed is that the NFIP's existing policy subsidies, which Congress set on a path to phase out in 2012, disproportionately benefit wealthier areas. As the Government Accountability Office (GAO) reported in 2012, 29 percent of subsidized policies were in counties in the top decile of median household income and 65 percent were in counties among the top three deciles.[3] In contrast, just 4 percent of subsidized policies were in the bottom decile and just 10 percent in the bottom three deciles.

The program's existing subsidies also flow from inland areas to coastal counties. As the Congressional Budget Office (CBO) reported in 2017, 85 percent of NFIP properties exposed to coastal storm surge pay less than full risk-based rates. According to the CBO, 29 percent of all Zone V properties are subsidized, because the properties were in place before flood maps were created for those communities, while 69 percent of Zone V properties are grandfathered, and pay Zone A or Zone X rates, despite their exposure to coastal storm-surge risk. Those totals include the 13 percent of Zone V properties that are both grandfathered and subsidized.

Ensuring that lower-income policyholders are not burdened with unreasonably high rates is crucial to carrying out the goal of phasing out the NFIP's subsidies and grandfathering. The Homeowner and Flood Insurance Affordability Act of 2014 placed all subsidized properties on a glide path toward actuarial rates, with annual premium increases that are capped at 15 percent. That bill also specified that properties newly mapped into special flood hazard areas receive preferred risk policies for the first year, and then likewise see annual increases of up to 15 percent until actuarial rates are achieved. This prevents any future grandfathering.

With the addition of an effective means-tested affordability program, such as the one proposed in the discussion draft, the committee should move forward with a plan to place on a glidepath the only cohort of properties currently scheduled to remain at below-full-risk rates: the pre-2014 grandfathered properties.

DEBT AND BORROWING AUTHORITY

The discussion draft would forgive the entirety of the NFIP's $20.5 billion debt to the U.S. Treasury. This comes in addition to the $16 billion of debt that Congress voted to forgive in October 2017. As in the 2017 bill, the discussion draft proposes that this debt cancellation be recognized as an emergency appropriation.

It is not feasible that the NFIP will ever be able to repay its debt in full. Of the nearly $40 billion the program has borrowed since 2005, it has, to date, repaid just $2.8 billion of principle. Indeed, as the CBO reported in 2017, under its current structure, the NFIP is expected to lose $1.3 billion in an average year, suggesting its debt will only grow larger. All the borrowed funds have already been disbursed. The only question that remains is when and how Congress will choose to recognize that expenditure.

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[3] https://www.gao.gov/assets/660/655734.pdf

The NFIP already has shown that there are fiscally responsible alternatives to taxpayer borrowing, with its successful transfer of more than $1 billion of risk each of the past three years to the reinsurance and catastrophe bond markets. If Congress is going to once again forgive the program's debt, and thus relieve the NFIP of the $400 million in annual interest payments it currently is obligated to make, it remains essential to cap the program's borrowing authority. This cap provides an important systemic prompt for Congress to revisit the NFIP's structure if it proves once again to be unsustainable.

While the $1.5 billion cap that was in place from 1996 to 2006 is arguably too stringent, the current $30.425 billion borrowing authority is so large as to provide no meaningful restriction on spending. A more reasonable approach would be to allow the program to borrow up to 1 percent of its total insurance in-force without further congressional authorization. Based on reported insurance in-force as of December 2018, that would mean a cap of roughly $13.1 billion.

PRIVATE FLOOD AND HIGHER COVERAGE LIMITS

The discussion draft would raise NFIP coverage limits from $250,000 to $500,000 for single-family homes and from $500,000 to $1.5 million for commercial properties. This change would shift onto the NFIP's balance sheet coverage that businesses and relatively high-net-worth homeowners currently obtain through excess and umbrella policies. The current $250,000 limit is more than adequate for most consumers, as it appropriately focuses on the cost of repair or reconstruction and does not force consumers to buy additional insurance covering the value of their land.

I am unaware of any evidence that residential or commercial policyholders currently face any notable affordability or availability issues in the market for excess flood coverage. In fact, the market for private flood insurance, including first-dollar coverage, has been growing rapidly. Based on the most recent statutory insurance filings, privately underwritten flood insurance grew by more than 50 percent from 2016 to 2017, from $412.6 million to $623.8 million.[4]

To the extent that members' concern is the impact of rising flood insurance rates being passed on in the form of higher rents, a more narrowly tailored provision raising coverage limits only for residential multi-family properties would address that issue more directly. Better still, Congress could consider a rental assistance voucher tied to the income of renters who reside in affected properties.

It should be noted that excess flood coverage is separate from the question of privately written first-dollar coverage. With regard to private flood, we saw in last year's devastating floods caused by Hurricane Florence that just 9 percent of households in South Carolina and just 3 percent in North Carolina carried flood insurance.[5] The marketing juggernaut that is the private insurance industry should be considered a valuable social tool to deploy toward the goal of closing what has been called "the protection gap."

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[4] https://www.insurancejournal.com/blogs/right-street/2018/03/18/483689.htm
[5] https://www.mcclatchydc.com/news/nation-world/article218292160.html

One additional step Congress could take to protect consumers, as the private market continues to grow, is to include a provision that has passed the House in the past, including unanimously in 2016, stipulating that consumers who move to private flood insurance and maintain continuous flood insurance coverage could later return to the NFIP at the same rate as if the consumer had remained with the NFIP all along. This would protect consumers if, for example, a private insurer raised rates, changed its underwriting approach or left the market.

The NFIP remains the nation's primary source of flood insurance. But there is no reason to expand the program's coverage limits or otherwise crowd out private coverage that already serves consumers well. If we are to adapt to rising flood risks, both public and private resources will be needed.

FLOOD MAPPING

We support the aims of the discussion draft on mapping, which would reauthorize the flood-mapping program and fund improvements to mapping technology, including the use of property-level Light Detection and Ranging (LIDAR) surveys. In a 2017 survey, the Congressional Budget Office found that of the 166 U.S. counties with expected annual flood claims of more than $2 million, together representing 89 percent of the NFIP's $3.7 billion in total expected annual claims, 83 counties had maps that were more than five years old and 17 had maps that were more than 16 years old.[6] Furthermore, those 16 counties alone accounted for 56 percent of the program's expected annual claims.

Improved mapping is therefore essential not only to the program's fiscal sustainability and its ability to charge risk-appropriate rates, but these improvements also are needed to ensure that homeowners, businesses and potential developers are not misled about the flood risks that properties are likely to face. I welcome the committee's commitment to invest in updated flood maps, though I have questions about some provisions of the draft legislation.

In the section dealing with privacy requirements, the bill would prohibit the FEMA administrator from disclosing personally identifiable information to the public. Given that property ownership records are readily available from municipal clerks, my concern is that this could be construed as prohibiting property-level flood risk surveys from being publicly available. While it is appropriate to balance privacy and transparency interests, there is general consensus about the need to disclose flood risk. The results of these surveys should be available to consumers when they are shopping for a home, to city planners and zoning boards when they are evaluating development projects and to private insurance companies when they are evaluating whether to underwrite flood risks.

Separately, the bill lays out a process for LIDAR surveys to be employed in the removal of low-risk structures from flood hazard areas "en masse." Certainly, it is likely that updated maps will reveal some

[6] https://www.cbo.gov/system/files?file=115th-congress-2017-2018/reports/53028-supplementalmaterial.pdf

properties that are inappropriately designated under the old maps. However, it is striking that the bill does not contain a parallel provision laying out a process for the "en masse" inclusion of previously undesignated properties into flood hazard zones. A February 2018 study published in the journal *Environmental Research Letters* found that roughly 41 million Americans are at risk of riverine flooding, more than three times FEMA's current estimate of 13 million.[7] Combined with the projected increased risk of both coastal and riverine flooding from sea-level rise, heavier winter rains and other impacts of climate change, we should expect on balance that more accurate mapping will result in more properties being added to flood hazard areas than would be removed.

BRINGING THE CBRS MODEL TO NFIP

Finally, I wanted to offer for the committee's consideration a proposed reform intended to ease the process of adaptation to increased coastal flooding and tropical storms that we expect to face as a result of sea level rise and climate change. Over the next century, we may be forced to contemplate relocating potentially hundreds of thousands of Americans to higher ground, should the Intergovernmental Panel on Climate Change's projections prove accurate. As a first step, it is critical that Congress reverse any federal policy that actively encourages Americans to move into harm's way.

Toward that end, the NFIP should cease writing coverage for any new construction in 100-year floodplains. The approach would be modeled on the success of the Coastal Barrier Resources System (CBRS), a 37-year-old program that bars federal subsidies to development across a 3.5-million-acre zone of beaches, wetlands, barrier islands and estuaries along the Atlantic Ocean, Gulf of Mexico and the Great Lakes. The law, signed by President Ronald Reagan in 1982, does not actually prohibit development within the CBRS. It merely prohibits programs like federal disaster relief, highway funds and the NFIP itself from operating in these areas. As a result, more than 80 percent of the CBRS zones remain undeveloped.

Not only has the CBRS been successful in preserving fragile coastal habitats and ecosystems, but it has done so while actually saving taxpayer funds. According to a forthcoming study from researchers Andrew Coburn and John Whitehead that will appear in the *Journal of Coastal Research*, between 1989 and 2013, $9.5 billion of federal expenditures were avoided due to the CBRS. The researchers attribute the bulk of that total to foregone FEMA disaster funds, with avoided expenditures by the Department of Transportation, the Environmental Protection Agency and the Department of Housing and Urban Development contributing smaller totals.

The study does not consider the cost of NFIP claims avoided due to the CBRS, but a stark example was provided by 2017's Hurricane Harvey. While Harvey's nearly $9 billion in NFIP claims were concentrated in and around the City of Houston, the storm actually made landfall some 200 miles away at San José Island, an uninhabited barrier island entirely within the CBRS. Much of the coastal regions of

[7] https://www.bristol.ac.uk/news/2018/february/america-flood-risk.html

surrounding Aransas County likewise fall within CBRS units and are thus largely free of development. It is impossible to know what development near Port Aransas might have looked like in the absence of the CBRS, but it is certainly conceivable that the devastation caused by Harvey could have been far worse.

This model of promoting conservation by removing federal subsidies has been adopted successfully elsewhere, including by several public insurance programs. The U.S. Department of Agriculture employs a version of it with its “swampbuster” and “sodsaver” conservation compliance programs, which limit subsidies that could serve as incentives to convert wetlands and highly erodible land to agricultural use. The State of Florida also adopted this approach in 2014, when it moved to prohibit new construction seaward of the state’s Coastal Construction Control Line (CCCL) from receiving subsidized insurance from the state-run Citizens Property Insurance Corp.

As with the CBRS, barring new construction in 100-year floodplains from NFIP eligibility would not foreclose the possibility that developers could find private insurers willing to sell coverage for an appropriate risk-based premium. It also would not relieve the challenges we will likely face in the years ahead with the stock of existing structures already in those zones. It would, however, apply the ancient wisdom of the Hippocratic Oath: “first, do no harm.” Where we can cease encouraging development of flood-prone land, without laying any new burden on any current resident, it is an opportunity we simply must take.

With that, I would be happy to answer any questions.