Flood Insurance Reform - What It Means To Buyers, Sellers, and Property Owners

By David Hamerslough

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For most of us, flood insurance is something we hear about when a natural disaster occurs, such as Hurricane Katrina, or when we review a Natural Hazard Disclosure Report to determine if a property is located in a flood zone. Most properties we own are not located in a flood zone or, if they are, they are not in a high-risk or special flood-hazard area.

As a result, many buyers, sellers, and property owners may not realize that most insurance companies have specifically excluded flood damage from homeowners' insurance. The government decided to address this need in the late 1960s when it established the National Flood Insurance Program (NFIP). This program enabled property owners in participating communities to purchase flood insurance if the community adopted flood plain management ordinances and minimum standards for new construction. Under the NFIP, the government subsidized the cost of flood insurance for primary residences, second homes, and commercial buildings. The program also contained grandfathering provisions allowing many buildings to keep their original flood risk rating, even if the flood zone designation was changed in a later flood zone map. Another exemption did not require the owners of existing homes and businesses to adhere to more stringent building codes that were enacted after the original maps upon which the program was based were created.

Over the years, the financial stability of this program has been adversely affected by the costs and consequences of repeated flooding and natural hazards, the exemptions and grandfathering provisions, and the cumulative effect of the subsidized premiums received by many property owners that did not accurately reflect the flood risk that their properties were exposed to, taking into account their location and elevation.

In July 2012, Congress passed the Biggert-Waters Flood Insurance Reform Act. This law is intended to strengthen the NFIP to ensure that it remains sustainable. In order to do so, the premium structure being offered by the NFIP must reflect the true risk and cost of flooding. The law extends the program for five years but requires significant reforms. All components of the program, including flood insurance premiums, flood hazard mapping, and grants, are scheduled to be reformed.

What this means to buyers and sellers and to property owners in general is that flood insurance premiums are expected to rise, certain events will cause an immediate increase in flood insurance premiums, and the remapping may cause properties previously not in a flood zone or in a lower-risk zone to now fall within a flood zone or a higher-risk zone, which will require flood insurance or increase the cost of that insurance.

The law sets up a timeline for when these changes are scheduled to take place. One of the dates that now triggers the new law was October 1, 2013. As of that date, an owner of a property in a flood zone who was not insured as of July 2012, the date when Biggert-Waters was enacted, or who has a lapsed NFIP policy, or who purchases a property after July 6, 2012, will now be subject to full-risk rates for flood insurance coverage.

Full-risk rates mean that the insurance premium reflects both the risk assumed by the program (what the government describes as the expected average claims payment) and all administrative expenses). In the case of flood insurance, this means the premium takes into account the full range of possible flood losses, including rare but catastrophic floods as well.

There are many factors that determine the full-risk rate of a structure. The single most important one, however, is the elevation of the structure in relation to the Base Flood Elevation (BFE). Flood insurance mapping identifies, among other things, the area of any community with a 1% or greater annual chance of flooding. These maps are referred to as Flood Insurance Rate Maps (FIRM). If a property is located in an area with a 1% or greater annual chance of flooding, such an area is called a special flood-hazard area or a high-risk zone. For a property in a high-risk zone, a buyer, seller, or property owner needs to know the elevation of the structure in relation to the BFE. Generally, the higher the elevation above the BFE, the lower the flood risk.

This information is shown on a document called an Elevation Certificate. There are two ways to obtain this certificate. The first is to contact local government officials. According to FEMA, many municipal governments keep elevation information on file, and FEMA suggests talking to community officials about the information they may have for any given property. If the property's elevation information is on file, the community flood plain manager is authorized to complete the Elevation Certificate.

The second way to obtain the Elevation Certificate and the method that must be used if the government official does not have this information is to hire a state-licensed and qualified engineer, architect, or surveyor to complete the document.

The Elevation Certificate will then be used to determine the premium for a flood insurance policy for a property in a high-risk zone. The amount of the premium will depend on what type of flood zone in which the property is located.

Special flood-hazard areas or high-risk zones are those beginning with the letter A or V. Moderate- to low-risk zones are those beginning with the letters B, C, or X. In moderate- to low-risk zones, rates are not based on elevation, so an Elevation Certificate may not be needed to determine the premium. It is important, however, for any property owner to remember that flood zone designations may change with the revised mapping and changes in building code requirements that may occur over time or following other flooding disasters, and an Elevation Certificate can potentially affect rates that might be paid.

Once an Elevation Certificate is obtained, a buyer, seller, or property owner provides the document to an insurance agent, who then calculates the premium for the flood insurance based upon the amount of coverage desired.

Given these changes and the importance of an Elevation Certificate, buyers, sellers, and property owners need to assess how these factors may affect the purchase and sale of property. While any of these issues are negotiable items in a purchase-and-sale transaction and market conditions may have an impact on choices made, it is advisable for buyers, sellers, and property owners to determine if a property is in a flood zone, the type of zone, whether an Elevation Certificate will be required, how long it will take and how much it will cost to get that certificate, what flood insurance will cost, what will be the impact of closing without an Elevation Certificate, etc.

If it is necessary to hire a state-licensed and qualified engineer, architect, or surveyor to complete an Elevation Certificate, costs for this service vary but can range from $500 to $2000. The qualified professional will need to visit the property. Generally speaking, it will take approximately two to three weeks for an Elevation Certificate to be obtained, although this can vary depending on demand and other factors. Buyers, sellers, and property owners should consider these costs and time constraints in determining whether they want to obtain a certificate up front, as part of a marketing plan, or as part of a contingency period in a purchase offer. The parties should also remember that they will need to take the Elevation Certificate to a qualified insurance broker to determine the insurance premiums and ultimate cost. Buyers will certainly want to know what this insurance will cost over the ownership of the property.

A qualified insurance broker can provide a provisional quote and policy before an Elevation Certificate is obtained. However, such a provisional policy may cost thousands of dollars more if no Elevation Certificate is obtained. While a certificate is not required in order for escrow to close, flood insurance will be required and will be provided at the provisional rate without the Elevation Certificate. A buyer would then have 60 days after close of escrow to provide an Elevation Certificate and obtain any refund in the difference between the actual cost of the flood insurance based upon the Elevation Certificate and the provisional rate. Buyers need to be aware that if they fail to provide the certificate within 60 days of closing, they forfeit the right to a lower insurance premium and will face a non-renewal of the policy on its anniversary. This consequence alone suggests that a buyer would be prudent to evaluate these issues thoroughly before deciding to purchase a property.

There are a number of other aspects of Biggert-Waters that impact second homes, commercial properties, and businesses. The reforms that are mandated are in the process of being finalized. Different phasing and cost considerations exist depending upon a number of factors. I recommend that any property owner review the law with a qualified insurance broker and other professionals to determine its impact.

Laurie and I had two very challenging real estate rights issues that we were advised were going to be difficult to prevail on. The RHRC team engaged with us and helped us understand our rights and prevailing position. RHRC were thoughtful advocates for us from the beginning to conclusion of our cases. We feel fortunate to know we will always be able to call on the firm in the future and that they are our legal counsel.

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