

Testimony of

**Jerry Passman
Passman Homes, Inc.**

On Behalf of the

Louisiana Home Builder's Association

**Field Hearing Before the
U.S. Senate Committee on Small Business and Entrepreneurship**

May 1, 2015

Introduction

Chairman Vitter, and members of the Senate Committee on Small Business and Entrepreneurship, thank you for the opportunity to testify today on the impacts of higher flood insurance rates on home owners, the housing industry and small businesses. My name is Jerry Passman and I am a home builder and small business owner from Baton Rouge, Louisiana, and the Immediate Past President of the Louisiana Home Builders Association (LHBA).

Here in Louisiana, home builders have seen firsthand the integral role that the Federal Emergency Management Agency (FEMA) plays after a major natural disaster. Likewise, the National Flood Insurance Program (NFIP) provides a vital service to home owners across the nation, reducing the impact of flooding on communities and ensuring we can rebuild when catastrophic flooding occurs. Ensuring that the NFIP is predictable, affordable and financially viable is essential to protecting the American Dream.

The National Association of Home Builders (NAHB) has a long history of supporting the NFIP, including fighting for passage of the *Biggert-Waters Flood Insurance Reform Act of 2012* (BW-12). However, dramatic rate increases resulting from the BW-12 reauthorization had a major negative impact on home sales. Congressional leadership from members such as yourselves helped reform the program through the passage of the *Homeowner Flood Insurance Affordability Act of 2014* (HFIAA). Although this law addressed many of the problems created by BW-12, recent actions by FEMA and the administration continue to create uncertainty for home buyers, home owners and small businesses.

Background

Since 1968, Congress has recognized the need to make affordable flood insurance available to home owners and small businesses to protect properties against the potential risk of loss from flooding. Congress also recognized the critical role that state and local governments would play to ensure the NFIP continues to be fiscally sound.

This strong partnership between FEMA and state and local governments require NFIP-participating communities to adopt and enforce strict building code requirements to ensure all new construction located in FEMA-mapped Special Flood Hazard Areas (SFHA) are designed and constructed in a flood-resilient manner.

In 1994, with passage of the *National Flood Insurance Reform Act*, Congress further cemented the direct link between the NFIP, the home building industry and the larger real estate industry. With this law, Congress required home owners to purchase NFIP-backed flood insurance for all properties located within the 100-year floodplain if they had a mortgage or home-equity loan financed by a federally-insured bank or backed by Fannie Mae or Freddie Mac.

In Louisiana, it is difficult to overstate the importance of the NFIP to home owners and home builders. Over 42% of the state's entire land mass is located within the 100-year floodplain, not including our current location, the city of New Orleans.

Unintended Consequences

In 2012, Congress worked to ensure the fiscal soundness of the NFIP through the passage of BW-12. This law mandates that all policyholders eventually pay the full actuarial risk rate for their properties.

While most properties insured by the NFIP, including all new residential construction, already pay full-risk rates, just over 20% of existing NFIP policyholders receive subsidized rates, generally between 40 and 45% of the actuarial premium. Most of these subsidized structures are Pre-Flood Insurance Rate Maps (Pre-FIRM); that is, a property built before 1974 when the first Flood Insurance Rate Maps (FIRMs) were established.

Prior to BW-12, FEMA continued to allow policyholders to pay less than the full actuarial rate if their home was built to meet previous flood risks, even if a more recent flood map placed them in a higher-risk zone. Here in Louisiana, a significant portion of the housing stock enrolled in the NFIP is “grandfathered” under this provision. In fact, according to a 2013 report by the United States Government Accountability Office (GAO), there are over 65,000 grandfathered properties in Louisiana, representing nearly 14% of all NFIP policies in the state.¹

Shortly after BW-12 was enacted, however, home owners and home builders started to see the unintended consequences of the legislation, especially on grandfathered or pre-FIRM properties.

First, any property that was sold was immediately subject to a full-risk rate, with the premium increasing by 25% each year until it reached the full actuarial rate. The potential buyer would get an unwelcome surprise at settlement, one that could even prevent the sale of the home if the rate increase was high enough to affect the buyer’s ability to qualify for financing. In addition, all pre-FIRM and grandfathered policyholders were subject to a similar phase-in to the full-risk rate, but it would occur over five years, with premiums increasing by 20% annually.

Remodelers were also experiencing problems with changes enacted through BW-12. Once renovations on insured pre-FIRM properties exceeded a “substantial improvement” threshold, full-rate premiums would be triggered. Traditionally the substantial improvement threshold of a renovation was 50% or more of the market value of the structure, and was based on a wide range of factors including zoning and building code standards. BW-12 lowered the threshold to 30%. This new threshold, instead of applying only to substantial improvements, now covered very simple remodeling jobs such as installing new appliances or updating bathrooms or kitchens. Once the 30% threshold was met, not only were home owners required to pay an increase of 25% of the full-risk rate per year, but they were also required to bring their property into compliance with their communities’ current regulations, which could be extremely expensive.

Were it not for Congressional leadership through the enactment of HFIAA, NAHB estimated that the move from the 50% to the 30% threshold would have placed up to \$8.5 billion in annual remodeling activity at risk. This major change to the substantial improvement threshold deterred property owners from making necessary and appropriate renovations and improvements by placing them at the risk of paying exorbitant premium increases. Additionally, home owners who may have been unable or

¹ U.S. General Accounting Office. (2013, July). *Flood Insurance: More Information Needed on Subsidized Properties*. (Publication No. GAO-13-607). Retrieved from U.S. Government Printing office: Retrieved from U.S. Government Printing Office: <http://gao.gov/assets/660/655734.pdf>

unwilling to maintain or repair their homes would see decreased property values that would have had a negative impact on communities, lenders and neighborhoods.

After BW-12, more and more home owners were not only seeing drastic increases to their flood insurance premiums, they were also seeing major errors in the flood maps. NAHB and LHBA heard from builders across the country who were distraught over the dramatic rate increases. Due to problematic maps and remapping, many of which have expanded the limits of the floodplain, builders have reported associated rate increases that have priced prospective buyers out of their developments and forced the cancellation of sales negatively impacting the local economy.

Some members were seeing rates increase as much as tenfold over what the home owners were previously paying. For example, due to inaccurate maps, a New Orleans couple had to cancel the purchase of their first home due to the flood insurance rates increasing from \$2,000 to \$6,550 per year. Another builder in Louisiana bought a home and realized the flood insurance rates on his home had increased from \$412 to the full-risk rate of over \$13,000.

Legislative Fixes

Thankfully, Congress, specifically the leadership here today, acted quickly to address the many unintended consequences of BW-12 by enacting *The Homeowner Flood Insurance Affordability Act of 2014* (HFIAA). This reform bill provided major relief for many of the strains BW-12 placed on the housing industry.

HFIAA reinstated the title of grandfathered properties, and the sale of pre-FIRM properties no longer triggered the immediate increase to full-risk rates. HFIAA also gave home owners a break by providing refunds to the eligible pre-FIRM property owners whose NFIP insurance rate premiums increased.

Thanks to Congressional leadership, FEMA is required to notify communities and their congressional delegations before updating FIRM maps under HFIAA. This is invaluable for pre-FIRM property owners who are selling their homes, who now will be informed if they have been remapped into a new floodplain and will be able to inform the home buyer of any additional NFIP requirements.

Under HFIAA Congress created the Flood Insurance Advocate, an office within FEMA responsible for ensuring NFIP policyholders and property owners understood FEMA's process for appealing a preliminary FIRM maps.

Further, the mapping error concerns have been remedied. Under BW-12, policyholders and communities who had used their own personal funds to challenge FIRM maps. If the FIRM maps were proven to be erroneous, the policyholder or community not able to be refunded the full expense of challenging the FIRM map. Therefore, many FIRM maps went unchallenged. Under HFIAA, FEMA is required to fully reimburse policyholders, or communities by removing a prior reimbursement cap (\$250,000 dollars) under BW-12 for successful challenges of erroneous FIRM maps.

To protect grandfathered properties, Congress mandated a surcharge across all NFIP policies, both pre-FIRM and full-risk rates, to offset the cost of continuing to subsidize their premium rates. Although the surcharge increases rates slightly, it is intended to bring the NFIP to a point of solvency until pre-FIRM rates gradually come to full-actuarial rates.

HFIAA also helps remodelers and home owners affected by the change to the substantial improvement threshold in BW-12, which increased NFIP premiums. HFIAA restored the threshold back to its traditional level of 50% or more of the market value of the structure, rather than the BW-12 rate of 30%. This will help to allow existing homeowners to stay in their homes and make the necessary repairs and upgrades without the fear of also triggering unsustainable insurance rate hikes.

Challenges Moving Forward

Although many positive changes were enacted through HFIAA, some challenges with the NFIP remain. Home builders are particularly concerned about potential changes to the NFIP and flood mapping that could result from a recent presidential Executive Order (E.O.) that expands the definition of a floodplain. On Jan. 30, President Obama signed E.O. 13690, updating a 1977 Executive Order on Floodplain Management (E.O. 11988), and created a new Federal Flood Risk Management Standard (FFRMS) for all federally funded or approved projects. As written, the new standard will drastically increase the geographic extent of a floodplain and could harm economic development across the country. Although FEMA has stated the E.O. and the FFRMS will not impact the NFIP because they “do not intend” to change the Special Flood Hazard Area definition, it remains to be seen what safeguards are in place to hold them to their word and keep the mandatory purchase of flood insurance tied to the 100-year floodplain.

In addition to potential effects on the NFIP, NAHB has serious concerns about the impact to private construction, the regulatory uncertainty this will cause, and the lack of oversight and public input sought.

For nearly 40 years the floodplain has been defined as an area with a 1% chance of annual flooding and is otherwise known as the 100-year floodplain. This definition not only governs federal buildings, but is the basis for the NFIP. Now, with only the President’s signature, the floodplain definition has been significantly expanded. Under E.O. 13690 and the FFRMS, each agency would be required to independently define floodplains using one of the following criteria:

- the best available climate-informed science;
- the freeboard approach (adding 2 or 3 feet of clearance above the base flood elevation); or
- 500-year floodplain (areas with a 0.2% annual chance of flooding)

Under BW-12, Congress authorized FEMA’s Technical Mapping Advisory Council (TMAC) to incorporate the effects of climate change, and to include the “best available science regarding future changes in sea level” into FEMA’s National Flood Mapping Program. NAHB questions whether each federal agency has the same capacity and scientific expertise to undertake this effort – map new areas, consider local flood control measures and analyze climate science on a local basis. Additionally, NAHB questions the need for each agency to replicate this process.

Regulatory Uncertainty

According to FEMA, each agency may use a different floodplain definition, based on any of the criteria previously mentioned. Home builders and developers rely on permitting programs and regulations that

are consistent, timely and predictable. When one agency defines the floodplain according to “climate-informed science,” another uses the “freeboard” approach, and yet a third adopts the 500-year floodplain, permit, loan, and grant applicants are left wondering where the requirements of the E.O. apply. To make matters worse, agencies are not required to use only one definition, but instead can apply different definitions on a project-by-project basis.

Private Development

While the E.O. states that it will apply to “federally-funded projects,” the original Executive Order and the FFRMS refer to “all federal actions.” This is defined as “(1) acquiring, managing, and disposing of Federal lands, and facilities; (2) providing Federally undertaken, financed, or assisted construction and improvements; and (3) conducting Federal activities and programs affecting land use, including but not limited to water and related land resources planning, regulating and licensing activities.” Putting aside the questions about the necessity for this E.O. and the ability of each agency to make such determinations, home builders are very concerned that these new definitions will be applied to projects well-beyond government buildings, directly impacting many private construction projects and indirectly impacting the NFIP.

While FEMA stresses that the new floodplain definitions will not impact NFIP rates or FIRMs, home builders and property owners are left wondering if structures in the 500-year floodplain or the ambiguously defined “climate-informed science” floodplain will soon require mandatory purchase of flood insurance. This uncertainty will devalue land and existing homes and businesses well beyond the long-accepted 100-year floodplain to which the NFIP, and indeed many other federal, state and local regulations, are tied according the definition of *special flood hazard area* (SFHA).

NAHB is also concerned about the impact of the E.O. and the FFRMS on development that receives federal grant funding (e.g. rural development grants, community development block grants, etc.), financing (e.g. FHA new construction) and permitting (e.g. Section 7 consultation under the Endangered Species Act, 402 and 404 permits under Clean Water Act, etc.), as the definition of “federal actions” clearly includes these types of activities.

Oversight

This E.O. was put into place without any congressional oversight or public input. While some agencies may need to go through a public rulemaking to effectuate the new definition of floodplain, some will be able to change their internal policies without any outside input. The FY 2015 Omnibus Legislation required FEMA to seek input from state and local governments. While FEMA hosted a series of listening sessions, all were completed after the draft implementation guidelines were released. Further, the administration has not made public any scientific or technical data to substantiate the basis for the new definition, a cost/benefit analysis to justify the definition, or even maps for regulators or the regulated community to review that show the extent of the floodplain according to the climate-informed science and freeboard approaches. And, in many locations, the 500-year floodplain is not mapped.

This new policy will drastically impact economic development across this country. Should the 500-year definition be adopted, the expansion of the floodplain could result in as much as a 20% increase in the floodplain area beyond the 100-year floodplain. No one knows the significance of the “climate-informed

science approach.” The Administration is putting the “cart-before-the-horse” in its attempt to implement the FFRMS before providing the necessary floodplain maps.

Home builders across the country hope that just as Congress helped to alleviate the problems stemming from BW-12, they will help rein in this overreaching E.O. and the many unintended consequences that will result.

Conclusion

I would like to thank the Committee for the opportunity to testify today, and specifically Chairman Vitter for his leadership on this issue. Forums like this one provide an important opportunity for members of the community to engage in the issues that impact our neighbors and local economy. Home builders have supported common sense changes to the NFIP through BW-12 and HFIAA, and we urge Congress to continue to support and protect Louisiana’s small business owners and home owners from the exorbitant rate hikes and inaccurate mapping we have seen in the past.