STATEMENT OF

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LOUISIANA REALTORS 2013 PRESIDENT

TO THE

UNITED STATES SENATE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

HEARING TITLED

HOW FLOOD INSURANCE RATE INCREASES AND FLOOD MAPPING POLICY CHANGES WILL IMPACT SMALL BUSINESSES AND ECONOMIC GROWTH

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Introduction
Chairman Vitter, thank you for the opportunity to testify. My name is David McKey, and I am the Managing Broker/Owner of Coldwell Banker One in Baton Rouge. I am here today representing the views of 11,350 members of the Louisiana REALTORS®. I have served the Louisiana REALTORS® most recently as State President in 2013. I also currently chair the Flood Insurance Working Group for the National Association of REALTORS®.

The REALTORS® appreciate your continued leadership on flood insurance and especially your hard work last Congress. We note that you were one of the original "Gang of Eight" that drafted the "Flood Insurance Affordability Act" which became Public Law #113-89. One year later, I'm pleased to report the Affordability Act has succeeded in reigning in the most excessive and inaccurate rate increases across Louisiana. We outline a few remaining issues below, but for the most part, the Affordability Act has addressed the most pressing and immediate concerns under the National Flood Insurance Program (NFIP). We look forward to continuing to work with you and the Senate on these and other issues before the current authority for the NFIP expires on September 30, 2017.

Importance of Small Businesses
Small businesses are the engine of economic growth in Louisiana. Small businesses provide the very competition which keeps prices down and spurs market innovations. They are responsible for most job creation within our great state. According to the latest statistics from the U.S. Small Business Administration, Louisiana's small businesses created nearly 25,000 jobs in 2012 alone and employed over half of the state's private workforce.[1] At the same time, flood insurance has become a significant expense for many property owners especially the small business owners who tend to have smaller production lines over which to spread the cost relative to their large competitors. For this reason, it is especially important that any flood insurance rate increases be spread out and gradually phased-in over time so that the small business owners has some time to transition, plan and adapt accordingly.

Implementation of the Biggert-Waters Law
Before the Affordability Act, thousands of small business owners in Louisiana were facing immediate and excessive rate increases under the Federal Emergency Management Agency's (FEMA) implementation the "Biggert Waters" Law. While most of the state's policyholders (83%) were already paying full cost for flood insurance, the 4% that weren't could see rate increases <u>in excess</u> of 25% when the property was purchased[2].

The crux of the problem was FEMA's implementation of Section 205. Under Biggert Waters, property owners including the small businesses were not supposed to see more than a 25% increase in any given year – regardless of whether the property had been sold or not. However, there was a separate provision in the law pertaining to home sales that prohibited the owners of "any property purchased" from paying less than full cost for flood insurance. This home purchase provision was not intended to apply to business property owners, but this was not technically reflected when the House and Senate versions of the law were reconciled and added to a 600-page transportation bill the night before the vote. It was the kind of legislative drafting issue that FEMA could have used its administrative discretion to clarify, but didn't.

To make matters worse, it took more than a year for FEMA to provide the necessary instructions for insurance companies to begin complying with the new law. As a result of this, as well as the lack of clarity on whether the home purchase provision applied to the business properties, insurers filled the vacuum by raising rates by 25% or more if the property sold and the insurer needed to close the gap between the subsidized rate and the full cost for flood insurance. For many business owners, the insurance renewal notice a year after the property's purchase was the first time they were informed of a substantial rate increase under "Biggert Waters."

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[1] For SBA's state profile of Louisiana, see: https://www.sba.gov/sites/default/files/advocacy/LA_0.pdf
[2] See NFIP's analysis of the impacts on the state of Louisiana: http://www.fema.gov/media-library-data/20130726-1912-25045-2652/bw12_impact_fs_04092013_louisiana_508.pdf

Real Estate Market Impacts

News reports of surprise "$30,000 flood insurance" notices drove buyers away from the floodplain and had a chilling effect on real estate markets everywhere. In addition, implementation of Section 207 loomed, which had not taken effect at the time but would have phased out "grandfathering" as well. Most property sellers did not know if their property had been grandfathered under lower risk rate tables at some point in the past. It did not matter that this information was included in the rate quote. All buyers knew was what they heard or read in the news and worried that they too could one day wake up to find a $30,000 bill in the mail. REALTORS® anecdotally reported that often their client's first words were not to show them any listings in the floodplain. As a result, many property owners were left with a property which could not be sold. Others began marketing their property as "does not require flood insurance." Also, according to RAND, a $500 premium increase is associated with a $10,000 decrease in property value based on previous research.[3] Not only were the increases affecting the sellers but also entire neighborhoods as winners and losers were picked. It was costing jobs and income in related industries and rippling throughout the local economy and community tax base.

REALTORS® help others buy and sell their properties. What differentiates the REALTOR® from other real estate agents is they conduct themselves by a higher code of standards governing their interactions with clients. They are the pillars of their communities. Much of their business comes from word-of-mouth referrals so it is especially important to the REALTOR® that they build and maintain working relationships with their former clients. How you get ahead in this business is by managing client expectations every step of way in the property buying process. Big surprises at the closing table are rarely good for business.

Biggert-Waters made an already difficult job more complicated. REALTORS® are a resource, but not the source of the information they provide their clients. It is hard enough for them to advise clients when the flood maps, where flood insurance is required for a mortgage, are not updated and usually inaccurate. Like the buyer, REALTORS® also rely on the insurance agent to quote accurate flood insurance rates.

With FEMA not immediately issuing instructions for insurance agents as to how to raise rates and applying the increases retroactively, insurance agents were not able to quote accurate flood insurance rates that reflected the law of the land. During the period when FEMA failed to act, thousands of properties were sold based on substantially inaccurate flood insurance rates. Worse, until only recently, the property owners did not even know whether their properties' insurance rates were subsidized or not. That information was not included with the flood insurance rate information until after the Affordability Act had passed.

When they received an insurance renewal notice with a large increase after the property's purchase, often one of the first calls from the property owner was to their REALTOR® demanding to know why this information was not disclosed sooner. The truth is the REALTOR® could not have known what the insurance agent did not quote them. Yet, trying to explain this to the client often did not help: At worst, the REALTOR® might be perceived as avoiding responsibility and at best, as someone who did not have the necessary information to sell the property.

Many REALTORS® tried to help their past clients by contacting FEMA directly, but typically, no one there seemed able or willing to verify the accuracy of the rate increases. Eventually, many turned to independent contractors who were hired to find and document mistakes in the rate quotes to try and bring down the rates. Most of the time, the contractor was able to find at least one mistake, but the insurance company often refused to make the rate changes until FEMA weighed in. In one case documented in NAR's earlier Congressional testimony, the contractor succeeded in reducing the rate from over $10,000 down to $500 per year because the insurance agents did not input the correct property information and did not check to see if the property was eligible for grandfathering.[4]

Flood Insurance Affordability Amendments

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[3] RAND. "Flood Insurance in New York City Following Hurricane Sandy," Pre-published report, 2013, page xxi.

[4] For more information about this, see example #3 in the appendix of NAR's November-2013 testimony before a House Financial Services Subcommittee: http://www.ksefocus.com/billdatabase/clientfiles/172/1/1914.pdf

The Flood Insurance Affordability Act addressed the most pressing issues facing newly-purchased business properties by repealing Sections 205 and 207. The bill required FEMA to re-set the rates back to pre-Biggert Waters levels for all properties, including those newly purchased, and cap their insurance rate increases going forward at no more than 25%. Within a few short months of passage, FEMA had re-set the rates. Within a year, FEMA had refunded most policy holders the difference between what they had actually paid versus what they should have paid – something that wouldn't have been necessary had FEMA implemented congressional intent all along.

The latest development in the implementation of the Affordability Act came about a month ago, when FEMA announced the 2015 insurance rates. Increases for 2015 amounted to about a 10% increase for the average policy holder. These increases were largely consistent with those prior to Biggert-Waters. In addition, policy holders were informed of a new surcharge – from $25 to $250 depending on the building. This surcharge paid for the recent rate changes under the Affordability Act. FEMA also established the new Office of the Flood Insurance Advocate to assist property owners when they have questions about the accuracy of their flood insurance rates and flood maps. Property owners should not have to hire outside contractors when it's FEMA's responsibility to instruct its own insurance contractors on how to implement FEMA's own rules. FEMA's office of the Advocate is intended to serve this function. FEMA is now in the process of transitioning the office from an interim to a permanent basis, and we are working with the Agency and Congress to find way to strengthen the office so it will become a "full-fledged" advocate for the property owner.

Recommendations on Remaining Issues

While the Affordability Act addressed the most excessive and inaccurate rate increases, there are still some remaining issues which we would like to bring to your attention:

1) **Long-term Reauthorization.** The National Flood Insurance Program will sunset in 2017 unless Congress renews program authority to provide flood insurance. We would urge the Congress to reauthorize the program for a minimum of another 5 years. Shorter term extensions only exacerbate market uncertainty and disrupt property sales where flood insurance is required for a federally related mortgage.

2) **Flood Insurance Rate Accuracy.**

   a) **25% Increases into Perpetuity**. Currently, the 25% increases for older ("pre-FIRM") properties do not end until the property owner (including business properties) is paying the full cost for flood insurance. The only way for an owner to demonstrate that they are paying the full cost is to obtain an elevation certificate which can cost anywhere from $500 into the thousands of dollars. If the elevation certificate shows the property owner is paying too much, the owner may request an optional "full-risk" rating under FEMA's guidelines to end the 25% increases. Yet, many of these owners are not aware of this option, which means that some could be paying a 25% increase that is not appropriate. There also seems to be some confusion over the $250 surcharge and its application to every building, including condos and detached structures, unless the owner declares that it is their primary residence. Recommendation: Clarify the 25% increases and provide for reimbursement for those who obtain an elevation certificate.

   b) **Elevation-Based Rating Errors**. The Affordability Act slowed the rate of increase but subsidized rates will keep increasing until they reach their full actuarial level as determined by an elevation certificate. If the procedures used to eventually rate these properties are not accurate, then the property owner could end up being over charged for flood insurance in the future. Most of the inaccurate rate increases we reviewed were for pre-FIRM properties located 2 or more feet below the Base Flood Elevation and mis-rated under special "Submit-to-Rate" procedures. We seek a full and thorough review of these procedures to ensure the accuracy of the flood insurance rates before subsidized properties begin paying too much for flood insurance. Recommendation: Request an independent actuarial review of FEMA's "Submit-to-Rate" procedures, strengthen insurance company training, and consider other incentives for accurate rates.

3) **Property Mitigation.** NFIP currently owes $23 billion on Treasury loans and one million properties are paying a "subsidized" rate. The more of these properties that are flood proofed, elevated, relocated or otherwise

strengthened against the risk of flooding, the lower the overall risk exposure of the NFIP and therefore taxpayers will be. Recommendation: Think outside the box and across the federal government to identify programs and funding opportunities for additional investments in mitigating pre-FIRM properties.

4) **Flood Insurance Advocate.** The Affordability Act established the office which was recently funded with appropriations. But the Office has not fulfilled its advocacy function of ensuring insurance rate accuracy. We understand that the Office is informally coaching some property owners on what questions to ask their insurance agent, but some are simply being referred back to the agent because the Office does not have the staff, resources and authority to directly contact every insurance company on every issue that arises with their insurance rate quotes. Recommendation: Clarify and provide additional authority and staffing for the Office to directly instruct insurance agents and companies when insurance rates are flawed and report on those issues it is not able to resolve under existing NFIP authorities.

5) **Flood Map Appeals.** FEMA must first issue regulations before it can begin reimbursing property owners when they successfully appeal flood maps. FEMA reports that such a rule could take several years to complete. At the same time, however, property owners have just 90 days to appeal in order to be eligible for reimbursement once those regulations are issued. Many property owners might succeed if they appeal the flood map but could be discouraged from doing so because they're outside the 90-day formal window or out-of-pocket on the cost to appeals. It is not clear why some should be reimbursed but not everyone who wins an appeal. In both cases, the map has been found to be inaccurate. As long as reimbursement is tied to a successful challenge, this should discourage appeals except when a property owner believes they have a sound basis to do so. Recommendation: Expedite reimbursement of successful appeals by allowing FEMA to issue guidance, instead of requiring a formal notice-and-comment rulemaking. Clarify that homeowners may appeal at any time and get reimbursed whenever they win.

Conclusion

Thank you for the opportunity to testify about flood insurance. We greatly appreciate the Committee's work in this area. We look forward to working with you and the Senate on these and other issues before the current authority for the NFIP expires on September 30, 2017.