Disclosure – Buying In A High Risk Flood Zone

In all fairness, the following is the minimum info that should be disclosed to those purchasing a property with a structure in the high-risk flood zone.

Definition of a High Risk Flood Zone. A flood zone beginning with the letter A (such as A, AE, A1 through A30, etc) or V (such as V, VE, etc) is a high-risk flood zone. This is called a Special Flood Hazard Area and federally backed lenders require flood insurance for the life of the loan. Currently, almost all flood policies are issued in the National Flood Insurance Program.

Building Amount Required. Each lender can say how much flood insurance they require on your building and their maximum deductible. Mortgages are often resold and each time your mortgage is re-sold to a new lender, that new lender can change their requirements. Requirements for the building limit can be: the outstanding loan amount [common with credit unions], 80% or 100% of the homeowners policy limit or 80% or 100% of the estimated building replacement cost. The required building limit and maximum deductible can vary considerably and change throughout the life of the mortgage.

$24+ Billion in debt. The National Flood Insurance Program (NFIP) has incurred huge debt since hurricanes Katrina, Rita, etc. and Superstorm Sandy. Storms resulting in major losses are occurring more frequently. Who will repay this debt but those required to buy flood insurance. Congress has mandated this debt be repaid and the premiums for policies in the NFIP now reflect higher base rates and additional fees.

Subsidized or Full Risk Rate? The **Biggert- Waters Flood Insurance Reform Act of 2012** (BW-12) called for flood insurance premiums to immediately rise from subsidized rates to full risk (actuarial) rates. This devastated the real estate market. Then in 2014 the **Homeowners Flood Insurance Affordability Ac**t (HFIAA) restored subsidized rates, temporarily, with gradual *annual* increases of 15% to 25%, *until full risk rates are reached.*

When you are quoted a flood insurance premium, your quote will be at the lesser of the subsidized rate or the full risk rate. So, at this point you have no idea of the full risk (actuarial) rate and therefore how high the premium will rise.

Pre-FIRM or Post-FIRM? Your structure is considered Pre-FIRM construction if it was built *before* your community's initial **F**lood **I**nsurance **R**ate **M**ap (FIRM) or before 12/31/1974. If built *after* your community's initial Flood Insurance Rate Map, it is considered Post-FIRM. This is an important factor in rating a flood policy. To search for the date of your community's initial Flood Insurance Rate Map, search www.fema.gov for "community status book". Click on the pdf for your state and find your community. Look in the fifth column.

Elevation Certificate (EC) **is needed**. Post-FIRM properties must use full risk rates. **An Elevation Certificate is required to determine full risk rates. Since Pre-FIRM rates will rise to full risk rates, Pre-FIRM property buyers also need an Elevation Certificate if they want to find out their full risk rate.** The cost for an EC may range from $300 to over $1,000. Should every prospective buyer arrange and pay for the Elevation Certificate so they can obtain the full risk rate, or should the seller provide the EC? Hmmm.

Pre-FIRM property buyers should ask their insurance agent to upload their EC to the insurance company and ask that company's Submit-For-Rate department for the current full risk premium quote.

The rate will be based on the difference between the Base Flood Elevation (BFE) and the floor used for rating, such as the top of the basement floor or the top of the crawl space.

Flood Insurance Rate Maps (FIRMs). FEMA's job is to determine the risk of flooding and educate property owners as to their risk. New *digital* flood maps (dFIRMS) are being issued for many areas. Check out your flood risk at http://msc.fema.gov or at your county map website. Or ask your community's Flood Plain Administrator (often the building inspector). Keep in mind that flood maps are revised regularly and future maps may change your flood zone for the better or worse.

Multiple valid rates. There may be multiple sets of valid rates. There is one National Flood Insurance Program (NFIP), with one common flood manual, used by the dozens of insurance companies writing flood insurance for the NFIP. All companies have access to the same sets of rates. NFIP rating is so incredibly complicated! The Flood Insurance Manual is revised multiple times each year; keeping up with the changes is humanly impossible. There are standard rates, elevation rates – maybe improved with proper venting, grandfathered zone/grandfathered elevation/grandfathered Built-in-Compliance rates, Newly Mapped rates, MPPP rates, tentative rates, Substantial Improvement rates, Severe Repetitive Loss rates, Primary/Non-Primary Residence tables & fees, etc. There are dozens of ways to improve or worsen the NFIP rates.

Private Market Flood Insurance. As mentioned above, almost all flood policies are currently issued through the NFIP. Pending federal legislation may make it easier for the private market, including Excess Lines programs such as through Lloyd's of London, to compete in this market. Private market flood programs "cherry-pick" those risks they think will be profitable. You may save up to 50% compared to the NFIP premium and won't be paying back the NFIP debt mentioned above. NY state consumer protections (including fees and required annually signed and filed forms) make it cumbersome and unattractive for the Excess Lines private market to do business in NY.

The NFIP takes all applicants. The lower risk properties subsidize those properties with more frequent and more severe claims.

Note that if you switch your NFIP policy with subsidized rates to a private market policy, after 60 days you are no longer eligible for NFIP subsidized rates. Keep this in mind in case you ever need to return to the NFIP program.

Substantial Improvement and Substantial Damage (SI/SD). Very few people are aware of the serious implications of this FEMA requirement. Substantial Improvement / Substantial Damage means improvement which equals or exceeds 50% of the market value before the improvement. An example of Substantial Improvement would be putting on an addition to the structure. An example of Substantial Damage would be a major loss at your home, such as a fire.

If a property in the high risk flood zone has SI/SD, it must be brought into compliance with FEMA's current standards for properties in a high risk flood zone, to minimize or prevent damage during a flood. This is "to protect the property owner's investment and safety, and, over time, to reduce the total number of buildings that are exposed to flood damage, thus reducing the burden on taxpayers through the payment of disaster assistance." **This could involve filling in a basement, elevating the building on a crawl space or perhaps on stilts, adding proper flood venting, etc.** For more information, search www.fema.gov for "Substantial Improvement/Substantial Damage Desk Reference FEMA P-758 / May 2010".

Conclusion. Selling a property in a high-risk flood zone should include full disclosure of those implications.

Ethics, moral and professional responsibility, Errors & Omissions, reputation, and future lawsuits and claims for damage are all involved. Legislation is needed to require full disclosure. Real estate agents, mortgage brokers, closing attorneys and government legislatures must no longer turn a blind eye to their ethical responsibilities to disclose the financial effects of buying in a high-risk flood zone. It is a matter of fairness. Novice property buyers are no match against experienced, licensed real estate professionals.

About the author. Daniel King has been a licensed property & casualty insurance agent for over 35 years and has talked with over 200 property owners or buyers in the US about flood insurance since 2010. He offers private market flood policy quotes at www.PrivateMarketFloodPolicy.com. He may be reached at dan.king@thilldemerly.com.