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Highlights

Highlights of GAO-09-20, a report to the Ranking Member, Committee on Banking, Housing, and Urban Affairs, U.S. Senate

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FLOOD INSURANCE

Options for Addressing the Financial Impact of Subsidized Premium Rates on the National Flood Insurance Program

Why GAO Did This Study

The Federal Emergency Management Agency (FEMA), the Department of Homeland Security (DHS) agency that administers the National Flood Insurance Program (NFIP), estimates that subsidized properties—those that receive discounted premium rates that do not fully reflect the properties' actual flood risk—experience as much as five times the flood damage as properties that do not qualify for subsidized rates. Almost one in every four residential policies has subsidized rates that are on average 35-40 percent of the full-risk rate. Unprecedented losses from the 2005 hurricane season and NFIP's periodic need to borrow from the Department of the Treasury to pay flood insurance claims has raised concerns about the impact that subsidized premium rates have on the long-term financial solvency of NFIP. GAO designated NFIP as high-risk in March 2006; as of June 2008, NFIP's debt stood at $17.4 billion.

This report (1) provides information on NFIP's inventory of subsidized properties and (2) examines NFIP's current approach to subsidized properties and the advantages and disadvantages of options for reducing the costs associated with these properties. To do this work, GAO analyzed data on policies and claims and collected available data about subsidized properties. GAO also reviewed applicable reports and interviewed relevant agency, state, and private sector officials. In its written comments, DHS expounded upon several topics discussed in this report.

To view the full product, including the scope and methodology, click on GAO-09-20. For more information, contact Orice Williams at (202) 512-8678 or williamso@gao.gov.

What GAO Found

While it constitutes a declining percentage of all NFIP policies, the number of properties receiving subsidized premium rates has grown since 1985; by 2007 it was at its highest point in almost 30 years. According to FEMA, this growth resulted from several factors, including a growing number of mortgages with mandatory flood insurance purchase requirements and greater enforcement of these requirements, the longer-than-expected life of the structures that are eligible for subsidies, and increased awareness of the dangers of floods from several major recent disasters and increased NFIP marketing efforts. To date, more than half of the subsidized policies are concentrated in five states with relatively high flood risk—California, Florida, Louisiana, New Jersey, and Texas. Current low participation rates—around 50 percent of single-family homes in high-risk areas—leave room for substantial growth in the number of NFIP policies, many of which would be likely to receive subsidized rates. Because of their relatively high loss experience and lower premium rates, the policies receiving subsidized rates have been a financial burden on the program, with total claims exceeding premiums by $962 million over the period from 1986 through 2004, before the large losses from the 2005 hurricanes. Without changes to the program, the number of subsidized properties will likely continue to grow, increasing the potential for future NFIP operating deficits.

As Congress evaluates the impact of subsidized premium rates, it is faced with balancing the public policy goals of charging premium rates that fully reflect actual risks, encouraging broad program participation through affordable rates, and limiting costs to taxpayers. While the current program of property-based subsidies and voluntary mitigation efforts—steps taken to reduce a property's flood risk such as relocation or elevation—encourages broad program participation, it is unlikely to substantially reduce the adverse financial impact of subsidized properties. GAO identified three options for addressing the financial impact of subsidized properties on the NFIP, each with advantages and disadvantages. One option would be to increase mitigation efforts, including making mitigation mandatory. Mitigation could help reduce flood losses, but the increased funding for such efforts could be high. A second option, eliminating or reducing subsidies, could improve NFIP's financial stability by increasing the number of policies that more accurately reflect the risk of flooding. However, the resulting higher premium rates could reduce NFIP participation and could meet resistance from local communities. A third option would be to target subsidies based on financial need, which could help ensure that only those in need receive subsidies, with the rest paying full-risk rates. However, it could be challenging for FEMA to develop and administer such a program in the midst of ongoing management challenges. While the inherent difficulty in determining premium rates adequate to cover potentially volatile and at times catastrophic flood losses means that the potential for the program to incur future operating deficits will always exist, implementing any or a combination of these options could significantly reduce the adverse financial impact of subsidies on NFIP.