



CRS Report for Congress

National Flood Insurance Program: Treasury Borrowing in the Aftermath of Hurricane Katrina

Rawle O. King
Analyst in Industry Economics
Government and Finance Division

Summary

In 2008, Hurricanes Ike, Gustav and Dolly made landfall in the United States, causing widespread flood damages. Estimates of federal flood losses from these three storms are not yet known. Exactly three years earlier, claims and expenses related to the massive flooding caused by Hurricanes Katrina, Rita, and Wilma (KRW) had financially overwhelmed the National Flood Insurance Program (NFIP). The program was self-supporting from 1986 until 2005, covering all expenses and claim payments out of cash flow of policy premiums and fees. The Federal Emergency Management Agency (FEMA), the agency that administers the NFIP, paid \$19.28 billion in KRW-related claims as a result of the 2005 Gulf Coast hurricanes. This amount exceeds the \$2.2 billion in premiums earned annually and its \$1.5 billion borrowing authority from the U.S. Treasury. As a result of the catastrophic property losses under the NFIP from KRW, in September 2005, the Congress passed and the President signed into law legislation to increase NFIP borrowing authority first to \$3.5 billion (P.L. 109-65) and then to \$18.5 billion (P.L. 109-106) in November 21, 2005, and finally to \$20.775 billion (P.L. 109-208) on March 23, 2006, to allow the agency to continue to pay claims.

FEMA estimates that the NFIP will need about \$3 billion in additional borrowing authority to cover the claims currently outstanding and a yet to be determined amount for the 2008 hurricanes. Under current law, funds borrowed from the Treasury must be repaid.

On September 27, 2007, the House approved H.R. 3121, the Flood Insurance Reform and Modernization Act of 2007, to reform the program while retaining its original intent to keep rates affordable for people to buy the insurance. H.R. 3121 would also increase the NFIP's Treasury borrowing authority from \$20.775 to \$21.5 billion. On November 1, 2007, Senator Christopher J. Dodd introduced S. 2284 to restore the financial solvency of the program and to forgive the debt. This report will be updated as events warrant.

Introduction

In 2008, Hurricanes Ike, Gustav and Dolly made landfall in the United States, causing a yet to be determined amount of federal flood losses. These three storms occurred exactly three years after Hurricane Katrina struck the U.S. Hurricane Katrina emerged as a pivotal event in the history of federal flood control policy. The storm damage and subsequent massive flooding in the Gulf Coast and New Orleans from Hurricane Katrina, estimated to have caused over \$200 billion in damages and over 1,700 deaths, was the most costly disaster in recent U.S. history. Hurricane Katrina exposed the fact that the cost of floods has continued to rise, as has the number of major flood disasters. Flood-related property losses have risen to \$6 billion a year, from approximately \$3.3 billion in the mid-1980s.¹ Katrina also demonstrated the effectiveness of the National Flood Insurance Program (NFIP) in managing the nation's flood risk as well as its limitations in handling a catastrophic flood event.

Congress created the NFIP with the passage of the National Flood Insurance Act of 1968² to provide insurance as an alternative to federal disaster assistance for individuals living in flood-prone areas. The NFIP has dual missions of promoting positive land use decision making and of reducing the overall cost to government of recovery costs due to flooding. The NFIP provides incentives for communities to establish flood plain management programs to control development in flood plain and promote flood-resistant construction.

Under the NFIP, the federal government is required to take certain actions:

- identify and map areas subject to flooding;
- indemnify property owners against flood losses by making flood insurance widely available at actuarially sound rates or with legally mandated subsidies; and
- reduce future flood-related losses through community floodplain management measures.

Since 1973, homeowners have had to buy flood insurance if they have federally backed mortgages in flood zones. Today, the NFIP provides flood insurance to about 5.4 million homeowners, renters, and business owners in over 20,218 participating communities, and generates \$2.3 billion in premiums.

The NFIP has undergone major changes in response to significant flood events. For example, the program was created after Hurricane Betsy devastated the Gulf Coast in 1965. Hurricane Agnes in 1972 led to the mandatory flood insurance requirements in 1973 that were designed to increase participation in the program. The Midwest flood of

¹ Alex Frangos, "U.S. Launching a Massive Effort to Redraw Nation's Flood Maps," *Wall Street Journal*, September 19, 2003, p. A 1.

² P.L. 90-448; 82 Stat. 573.

1993 provided the impetus for strengthening lender compliance requirements in the context of the mandatory purchase provisions in the 1994 National Insurance Reform Act.³ Recognition of the impact of properties prone to repetitive flooding on the financial condition of the program led to the passage of the Flood Insurance Reform Act of 2004.⁴ In the wake of Hurricane Katrina, a question has been raised as to whether the current model for financing the NFIP — through premiums, fees, and treasury borrowing in high-claim years — remains the best alternative.

The devastation in the Gulf Coast caused by Hurricanes Katrina, Rita, and Wilma (KRW), and predictions for more intense storms in the future, have raised broad public policy concerns about the future viability of the NFIP, particularly in the event of another catastrophic flood episode. A key policy issue for the 110th Congress is finding a way to balance the financial and regulatory need to strengthen the program and ensure its future viability and commitment to reduce the nation's flood risks without undermining the original intent of the program to keep rates affordable. Members of the 110th Congress will likely be called upon to assess the NFIP's current operations and accomplishments and consider various alternatives to reform the program. The options for NFIP reforms include eliminating the program, broadening its coverage from the 100-year flood plain to the 500-year flood plain, and enhancing both the program's actuarial soundness and the accuracy of flood maps. Economists note that these flood insurance reforms could affect the U.S. economy and have unintended impacts on home ownership, including property values and the cost of mortgage credit.

Katrina's Impact on the National Flood Insurance Program

The massive flood losses from the 2005 hurricane season, especially Katrina and Rita, have financially overwhelmed the NFIP. The program had been self-supporting from 1986 until 2005, covering all expenses and claim payments out of income from premiums and fees. Operating losses occurred annually between 1972 and 1980 and in the years 1983, 1984, 1989, 1990, 1992, 1993, 1995, 1996, 2004, and 2005. The Federal Emergency Management Agency (FEMA), the agency that administers the program, expects to pay approximately \$20.7 billion in claims from KRW. This figure is almost double the total amount paid out over the NFIP's 39-year existence. According to FEMA, between 1978 — when the program was transferred from the Department of Housing and Urban Development to FEMA — and 2004, the NFIP earned \$19.7 billion in premiums and paid out \$14.2 billion. Some 184,495 NFIP claims have been filed in response to KRW. To place this number in context, prior to Katrina, the largest numbers of flood-related claims from previous floods were from the Louisiana flood of May 1995 (31,264), Hurricane Allison in June 2001 (30,296), and Hurricane Ivan in 2004 (28,137).⁵

³ P.L. 103-325; 108 Stat. 2255.

⁴ P.L. 108-264; 118 Stat. 712.

⁵ U.S. Department of Homeland Security, *Significant Flood Events: 1978-December 31, 2007*, [<http://www.fema.gov/business/nfip/statistics/sign1000.shtm>].

NFIP's Treasury Borrowing

One result of the catastrophic nature of flood losses from KRW is that FEMA had to stop payments to NFIP policyholders for the first time since the flood insurance program began. Although the NFIP has been able to cover losses through the premiums charged to all policyholders, total income generated from insurance premiums and investments has at times been insufficient to pay claims in heavier loss years. In such cases, the program has borrowed from the U.S. Treasury to cover losses and other expenses in the short term.

Total flood insurance losses from KRW, estimated at \$23 billion, significantly exceeded the program's \$1.5 billion borrowing authority from the U.S. Treasury. Consequently, in September 2005, the Congress passed and the President signed into law legislation to increase NFIP borrowing authority to \$3.5 billion.⁶ Subsequent legislation that further raised borrowing authority to \$18.5 billion was enacted in November, 2005.⁷ On March 23, 2006, the U.S. Congress approved S. 2275 to increase the borrowing authority to \$20.775 billion.⁸

Table 1 shows the history of Treasury borrowing and repayments under the NFIP from 1981 to 2007. FEMA projects having to pay \$20.697 in ultimate losses from KRW, an amount that includes \$1.26 billion in interest. As of July 31, 2008, FEMA had borrowed \$17.835 billion and repaid \$225 million, leaving a current balance of \$17,360. Given that the NFIP insures \$75 billion in property values in the three identified coastal counties in Texas and the Houston metropolitan area impacted by Ike, it is likely that the program will incur significant losses from this storm which will necessitate additional Treasury borrowing.

Federal Response to Uninsured Flood Losses

Katrina's devastation has required an unprecedented response from federal, state, and local governments, as well as the private sector. Federal spending for post-disaster assistance now totals \$109 billion, plus more than \$8 billion in tax relief.⁹ This \$109 billion amount includes \$89.6 billion in post-disaster assistance and \$19.3 billion in insurance claim payments under the NFIP. As of December 31, 2006, the NFIP had borrowed \$16.75 billion from the U.S. Treasury — an amount that far exceeds the aggregate amount of claims paid in the history of the program.¹⁰ The \$89.6 billion appropriated by Congress includes \$11.5 billion in U.S. Department of Housing and

⁶ P.L. 109-65; 119 Stat. 1998.

⁷ P.L. 109-106; 119 Stat. 2288.

⁸ P.L. 109-208; 120 Stat. 317.

⁹ Matt Fellowes and Amy Liu, "Federal Allocations in Response to Katrina, Rita and Wilma: An Update," *The Brookings Institutions*, located at [http://www.brookings.edu/metro/pubs/20060712_katrinafactsheet.pdf#search=%22community%20development%20block%20grant%20and%20katrina%20flood%20relief%22].

¹⁰ U.S. Government Accountability Office, *Hurricane Katrina: GAO's Preliminary Observations Regarding Preparedness, Response, and Recovery*, GAO-06-442T (Washington: March 8, 2006), p. 38.

Urban Development (HUD) Community Development Block Grant (CDBG) funds for five states (Alabama, Florida, Louisiana, Mississippi, and Texas) affected by KRW.¹¹ The majority of the CDBG funds will be used to compensate homeowners in Louisiana and Mississippi for the value of their homes, up to their insured value or \$150,000, whichever is less. Grants are now available to thousands of homeowners outside of Special Flood Hazard Areas, commonly known as the flood plain or the flood zone, who were not required by federal law to purchase flood insurance.

In addition to stimulating calls to reform the NFIP, Hurricane Katrina has rekindled national debate as to whether the federal government should pay for catastrophe losses that are not covered by insurance either because the damage was caused by excluded perils, or because the insurance has become insolvent, or because the persons or entities suffering the losses were not insured. Because a future mega-catastrophic event could cripple the insurance industry's financial base and disrupt recovery after the next major disaster, there are renewed calls for federal disaster insurance.

There is a lack of consensus, however, among state officials and insurance stakeholder groups about the viability of a federal catastrophe fund. Some segments of the insurance industry maintain a federal catastrophe fund is not needed because either the private sector remains capable of covering such risks or they are not willing to help with financial assistance to residents of coastal areas.¹² Supporters of this view argue that a government solution would amount to a coverage subsidy for coastal residents at the expense of those living further inland and increase the risk of taxpayers being forced to cover losses. On the other hand, other insurers and their trade groups say there is not enough capital in the catastrophe insurance market to handle a mega-catastrophe, and a federal-state catastrophe funding approach would be the most effective way to mobilize resources needed for disaster recovery and federal deficit reduction. Insurers and regulators are also exploring ways to allow for insurers to accumulate tax-deferred catastrophe reserves.

Concluding Remarks

The NFIP is so deeply in debt from the 2004 and 2005 hurricane seasons that most insurance analysts would agree it will be challenging for FEMA to repay the money borrowed from the Treasury. The interest payments alone on NFIP's Treasury borrowing could reach \$1 billion per year, which is half the program's annual premiums, suggesting the unlikelihood that FEMA will be able to repay the borrowed funds. Most disaster experts and policymakers would agree that the program needs to be reformed, and some have suggested the program should be restructured to operate more like a private insurer. The 110th Congress is expected to act first to address solvency issues, particularly the

¹¹ The CDBG funds were allocated as follows among the Gulf states: Alabama, \$74.4 million; Florida, \$82.9 million; Louisiana, \$6.2 billion; Mississippi, \$5.1 billion; and Texas, \$74.5 million. For more information, see CRS Report RL33330, *Community Development Block Grant Funds in Disaster Relief and Recovery*, by Eugene Boyd.

¹² Matt Brady, "War of Words Erupts Over Disaster Fund," *National Underwriter, Property & Casualty*, January 23, 2006, p. 6.

NFIP's outstanding borrowing and repayment, and then undertake a legislative review and possible overhaul of the program.

Table 1. History of U.S. Treasury Borrowing Under the National Flood Insurance Program

(As of July 31, 2008, \$ Constant)

Fiscal year	Amount borrowed	Amount repaid	Cumulative debt
Prior to FY1981 ^a	\$ 917,406,008	\$ 0	\$ 917,406,088
1981	164,614,526	624,970,099	457,050,435
1982	13,915,000	470,965,435	0
1983	50,000,000	0	50,000,000
1984 ^b	200,000,000	36,879,123	213,120,877
1985	0	213,120,877	0
1994 ^c	100,000,000	100,000,000	0
1995	265,000,000	0	265,000,000
1996	423,600,000	62,000,000	626,600,000
1997	530,000,000	239,600,000	917,000,000
1998	0	395,000,000	522,000,000
1999	400,000,000	381,000,000	541,000,000
2000	345,000,000	541,000,000	345,000,000
2001	600,000,000	345,000,000	600,000,000
2002	50,000,000	650,000,000	0
2005 ^d	300,000,000	75,000,000	225,000,000
2006	16,660,000,000	0	16,885,000,000
2007	650,000,000	0	17,535,000,000
2008 to date	50,000,000	225,000,000	17,360,000,000
Total	\$21,719,535,534	\$4,359,535,534	\$17,360,000,000

Source: U.S. Department of Homeland Security, Federal Emergency Management Agency's Office of Legislative Affairs.

Note: Borrowings through 1985 were repaid from congressional appropriations. Borrowings since 1994 have been repaid from premium and other income.

a. Balance forward from U.S. Department of Housing and Urban Development.

b. Figure for the \$213.1 million in cumulative debt in 1984 were provided by FEMA. It reflects additional cost outside of the insurance program.

c. Of the \$100 million borrowed, only \$11 million was needed to cover obligations.

d. The NFIP borrowed \$300 million in 2005 to pay claims from the 2004 hurricane season. Note: Hurricanes Katrina, Rita and Wilma struck in the fall of 2005, after the 2006 fiscal year began.