The Impact of the National Flood Insurance Program’s Risk Rating 2.0 on Southern Louisiana

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Summary

The National Flood Insurance Program (NFIP) is a Federal program administered by FEMA which sells flood insurance to homeowners, renters, and businesses. In 2021, the NFIP began implementing Risk Rating 2.0, a new methodology for calculating flood risk that more accurately assesses flood risk. As the previous method tended to undervalue property risk, this change is leading to substantial rate increases in higher-risk areas like Southern Louisiana. Increased rates may help the NFIP pay down its substantial debt. Rate increases threaten Southern Louisiana by making citizens who can no longer afford flood insurance vulnerable to flooding and increasing the cost of living for those who still choose to buy flood insurance. In addition, FEMA has released little information on the impact or extent of these rate increases, making it difficult for communities and policymakers to respond accordingly.
While the NFIP’s debt is a real concern, achieving solvency should not come at the expense of providing flood insurance to those who desperately need it. The NFIP should pause Risk Rating 2.0 to give Congress time to pass needed legislation. Within this pause, Congress should pass need-based aid to offset the worst impacts of Risk Rating 2.0 and enact debt cancellation measures to address the NFIP’s debt. In addition, FEMA should make Risk Rating 2.0’s impact on policyholders transparent before resuming any rate increases.

Background

*The National Flood Insurance Program and Risk Rating 2.0*

The NFIP was established in 1968 by the National Flood Insurance Act to, one, provide flood insurance beyond what the private market could affordably administer and, two, mitigate flood risk through floodplain management standards.¹ Under the original system, premiums were based on risk estimates calculated from a property’s flood zone, elevation, and occupancy type.²

Since 2005, the NFIP has maintained growing debts (above). Legislation in 2012 and 2014 attempted to address the NFIP’s insolvency raising rates to more accurately reflect risk and eliminate certain subsidies³ while protecting affordability through a temporary subsidy for certain high-risk properties and capping rate increases between 5-18% annually.⁴ In October of 2021, the NFIP began rolling out Risk Rating 2.0, a massive overhaul in how the NFIP sets rates. Risk Rating 2.0 does away with flood zone-based models which underestimated most properties’ risks, instead relying on a multi-model system that incorporates many variables, including a property’s proximity to water property and its potential rebuilding costs.⁵ New policies saw this change
immediately, in October of 2021, while existing policies were subject to this change starting in April of 2022.⁶

*Southern Louisiana and Risk Rating 2.0*

Southern Louisiana has some of the highest flood risks in the country due, in part, to a combination of low, subsiding elevations, coastal erosion, high precipitation, frequent storm surges, and rising sea levels due to climate change.⁷ The First Street Foundation, a nonprofit climate research group, estimates that seven of the top ten counties/parishes in the US at greatest risk of flooding are in Southern Louisiana⁸ and that Louisiana will see far greater flood risk increases than any other state in the next 30
Louisiana has a “working coast” with important economic engines along its coastline (above), including 5 of the US’s 15 largest ports, 20 percent of all US waterborne commerce, and 23 percent of US crude oil production. Louisiana also has some of the lowest median household incomes of any state and most of Southern Louisiana lies in the Special Flood Hazard Area, or SFHA (above). Properties inside the SFHA must buy flood insurance to obtain a federally backed-mortgage.

Flood insurance is an important element of Louisiana’s disaster recovery process. For example, after a major flood in 2016 caused $3.8 billion damages to residential property alone, the NFIP paid out $2.5 billion in claims. Despite comprising roughly 2% of the US population, Louisiana citizens hold 10% of National Flood Insurance Program (NFIP) policies (458,000 policies).
The exact consequences of Risk Rating 2.0 for Southeast Louisiana are unclear. FEMA has published expected annual rate increases (above), but expected full rate increases over multiple years have not been disclosed. FEMA estimates that half of all policies will see rate increases for more than 5 years and 10% of policies will see rate increases for more than 10 years. In addition, most large rate increases are
concentrated in the South while most decreases are in the North (below). Since October of 2021, the number of policies in force in Louisiana has decreased by 4.3% (22,000 policies).\textsuperscript{18} NFIP premium revenues from the three fiscal quarters following the change do not show clear increases compared to previous quarters (above).

Relevant stakeholders include Southeast Louisiana residents, local insurance agents, realtors, and businesses, coastal industries, housing developers, environmental justice advocates, floodplain managers, and policymakers, primarily FEMA.

\textit{Policy Analysis}
Transparency

Many stakeholders are concerned with the lack of transparency in Risk Rating 2.0’s rate changes. Interviewed stakeholders in the realty and insurance industry described the rating system as a “black box” in which the NFIP calculates insurance rates without disclosing their methods or how much Risk Rating 2.0 will increase rates over multiple years.\(^{19,20}\) Without this information, policyholders can’t make informed decisions when renewing policies or purchasing building improvements\(^{21}\) and stakeholders can’t properly analyze the change,\(^{22}\) instead turning to estimates from groups like the First Street Foundation (right) and reporting from the New Orleans-based *Times-Picayune*, which found that Louisiana’s average rate increase will be 122%.\(^{23}\)

<table>
<thead>
<tr>
<th>Municipality</th>
<th>Average expected loss</th>
<th>Average premium</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lacombe</td>
<td>$8,538</td>
<td>$853</td>
<td>901%</td>
</tr>
<tr>
<td>Covington</td>
<td>$7,745</td>
<td>$781</td>
<td>891%</td>
</tr>
<tr>
<td>LaPlace</td>
<td>$6,750</td>
<td>$883</td>
<td>664%</td>
</tr>
<tr>
<td>Houma</td>
<td>$4,231</td>
<td>$582</td>
<td>627%</td>
</tr>
<tr>
<td>Luling</td>
<td>$5,591</td>
<td>$819</td>
<td>583%</td>
</tr>
<tr>
<td>Reserve</td>
<td>$3,081</td>
<td>$495</td>
<td>523%</td>
</tr>
<tr>
<td>New Orleans</td>
<td>$3,219</td>
<td>$577</td>
<td>458%</td>
</tr>
<tr>
<td>Eden Isle</td>
<td>$5,649</td>
<td>$1,087</td>
<td>420%</td>
</tr>
<tr>
<td>Belle Chasse</td>
<td>$3,231</td>
<td>$641</td>
<td>404%</td>
</tr>
<tr>
<td>Meraux</td>
<td>$2,491</td>
<td>$502</td>
<td>397%</td>
</tr>
</tbody>
</table>

Source: First Street Foundation

On the NFIP’s side, an anonymous FEMA official argued that Risk Rating 2.0 is relatively transparent, as its website includes a thorough explanation of its methodology and a worksheet of premium calculation examples.\(^{24}\) However, this worksheet can’t be edited to calculate one’s own premium.\(^{25}\) The official acknowledged that FEMA realizes the system could be more transparent and that they are working on it.
**Risk Evaluation**

FEMA claims that Risk Rating 2.0 is a far more equitable, accurate way to calculate flood risk than the previous system. The prior rating system did not take rebuilding costs into account, which led lower-valued homes to pay more and higher-valued homes less than their commensurate risk. Risk Rating 2.0 corrects this by considering rebuilding costs in addition to the many other variables which more closely align ratings with risk. In addition, the FEMA official argued that accurate risk ratings helped the NFIP better understand the overall flood risk of US citizens.

Opposing stakeholders question FEMA’s claims about equity and accuracy as they pertain to Southern Louisiana. In addition to interviewed stakeholders, the editorial board of the *Times-Picayune* argues that Louisiana’s mostly “working coast” doesn’t have many high-value coastal residential properties to subsidize. Windell Curole, general manager of the South Lafourche levee district, doubts the accuracy of Risk Rating 2.0 in accessing levee protection, as it underestimates Bayou Lafourche’s flood protection compared to its historical performance.

**Risk Mitigation and Affordability**

Risk Rating 2.0’s substantial rate increases are raising housing costs and decreasing property values, according to opposing stakeholders. St. Charles Parish President argued that high rates will “kill our community.” One insurance agent noted that real estate development has slowed to a halt because of high rates depressing demand and, anecdotally, that some families have been essentially bankrupted by the change. This may be especially true for families required to purchase flood insurance because of mortgages.
Rising costs could lead many homeowners to forgo flood insurance. Some property owners who forgo flood insurance may be denied certain types of FEMA disaster aid by statute, exacerbating future flood disasters.

The interviewed FEMA official pointed to solvency as a key reason for rate increases, as the NFIP faces pressure from Congress to reduce its debt and cost to taxpayers. In addition, the official noted that policyholders see higher rates because of the interest which the NFIP must pay on its debt, making solvency beneficial for policyholders.

**Recommendations**

FEMA should open Risk Rating 2.0 as soon as possible. On the NFIP website, any customer should be able to enter their property’s information and see how much their rates will increase, over what time scale, and what factors are affecting their rates most, akin to an online mortgage calculator. Policyholders should be able to know their full rates before purchasing flood insurance and policymakers should have access to extensive data from which to implement affordability legislation.

To that point, FEMA should pause Risk Rating 2.0 while it works to make the program transparent and until an affordability framework is resolved. Risk Rating 2.0 is valuable because it provides accurate information on individual flood risk, but this information means less if Southern Louisianans can’t afford to insure against it. FEMA must give Congress time, perhaps 2-3 years, to pass affordability legislation that is already in the works. FEMA should also explore affordability subsidies within its purview in case Congress fails. While the NFIP’s debt is an important issue, solvency should not come at the cost of the NFIP’s central purpose – providing affordable flood insurance in
an unprofitable market – especially because the NFIP’s quarterly earnings do not indicate that Risk Rating 2.0 is immediately raising revenues.

Congress should cancel the NFIP’s current debt and any debts incurred in the future from 100+ year floods and pass need-based aid for flood insurance. This would address the NFIP’s solvency issues while lowering costs for policyholders, ensuring that low-middle-income residents are not displaced from their homes because of flood insurance costs. Debt cancellation and affordability frameworks will cost taxpayer money, but the $391 billion in climate and energy spending under the recent Inflation Reduction Act\(^3\) indicates that there is political will to take on this extra financial burden. Moreover, it is worth taxpayer money to protect the viability of Southern Louisiana, both as a region of immense economic, strategic, and cultural importance and as a region populated by fellow citizens who only want to keep their homes.

Endnotes


3. Ibid, 1.


6. Ibid.


19. Zoom Interview with Kelli Starrett, CEO of the New Orleans Metropolitan Association of Realtors (Nov. 7, 2022)

20. Email Exchange with Benjamin Albright, Vice President of Strategic Initiatives for the Independent Insurance Agents & Brokers of Louisiana, (Nov. 17, 2022)

21. Zoom Interview with Kelli Starrett, CEO of the New Orleans Metropolitan Association of Realtors (Nov. 7, 2022)

22. Email Exchange with Benjamin Albright, Vice President of Strategic Initiatives for the Independent Insurance Agents & Brokers of Louisiana, (Nov. 17, 2022)


24. Zoom interview with FEMA official, (Nov. 21, 2022)


27. Zoom interview with FEMA official, (Nov. 21, 2022)


29. Zoom Interview with Kelli Starrett, CEO of the New Orleans Metropolitan Association of Realtors (Nov. 7, 2022).

30. Phone Interview with Windell Curole, General Manager of the South Lafourche Levee District, and Ms. Curole (Nov. 15, 2022).

31. Ibid.


33. Email Exchange with Benjamin Albright, Vice President of Strategic Initiatives for the Independent Insurance Agents & Brokers of Louisiana, (Nov. 17, 2022)

34. “Special Flood Hazard Area (SFHA).” FEMA.gov. Federal Emergency Management


36. Zoom interview with FEMA official, (Nov. 21, 2022).

37. For reference, consult mortgagecalculator.org.