CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

July 24, 2017

H.R. 2246
Taxpayer Exposure Mitigation Act of 2017

As ordered reported by the House Committee on Financial Services on June 21, 2017

SUMMARY

H.R. 2246 would eliminate the requirement for commercial properties in flood zones to have flood insurance if the properties are financed by a federally regulated lending institution, or a federal lender. The bill also would require the Federal Emergency Management Agency (FEMA) to acquire coverage for a portion of the National Flood Insurance Program's (NFIP) potential cost from the private reinsurance or capital markets annually. Finally, H.R. 2246 would require FEMA to permit localities to develop and submit their own maps of local flood risks for FEMA's review and approval for use in determining NFIP insurance rates.

The cost to enact H.R. 2246 is uncertain and would depend on the number of commercial properties that drop NFIP coverage. CBO estimates that enacting H.R. 2246 would increase direct spending by $325 million over the 2018-2027 period, although costs could be significantly higher or lower. CBO also estimates that implementing the bill would cost $40 million over the 2018-2022 period, assuming appropriation of the necessary amounts.

Because enacting H.R. 2246 would affect direct spending, pay-as-you-go procedures apply. Enacting the legislation would not affect revenues.

CBO estimates that enacting H.R. 2246 would not increase net direct spending or on-budget deficits by more than $5 billion in any of the four consecutive 10-year periods beginning in 2028.

H.R. 2246 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary effect of H.R. 2246 is shown in the following table. The costs of this legislation fall within budget function 450 (community and regional development).

	By Fiscal Year, in Millions of Dollars												
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2017-2022	2017-2027
INCREASES IN DIRECT SPENDING													
Estimated Budget Authority	0	5	5	15	30	40	40	45	45	50	50	95	325
Estimated Outlays	0	5	5	15	30	40	40	45	45	50	50	95	325
INCREASES IN SPEDNING SUBJECT TO APPROPRIATION													
Estimated Authorization Level	0	1	10	10	10	10	10	10	10	10	10	41	91
Estimated Outlays	0	1	9	10	10	10	10	10	10	10	10	40	90

BASIS OF ESTIMATE

For this estimate, CBO assumes that H.R. 2246 will be enacted near the end of fiscal year 2017 and that the necessary amounts will be appropriated for each fiscal year.

Background

Under current law, residential and commercial property owners can choose to buy flood insurance through the NFIP. Property owners who buy coverage through the NFIP pay annual premiums which are deposited into the National Flood Insurance Fund (NFIF) and are used to pay flood damage claims submitted by policyholders.

Mandatory Purchase Requirement. Owners of properties that are located within an area designated as having at least a 1 percent chance of being flooded in any year (known as a Special Flood Hazard Area, or SFHA) and that are financed by a federally regulated lending institution, government sponsored enterprise for housing, or federal lender are required to carry flood insurance. Property owners not receiving financing from those entities or located outside an SFHA may purchase flood insurance coverage from a private carrier or the NFIP at their discretion. The level of compliance with this requirement is unknown.

Currently, there are about 5 million properties insured by the NFIP. Of those properties, about 340,000 (or 6.7 percent) are commercial properties, CBO estimates. How many of those properties are subject to the mandatory purchase requirement is unknown because the properties' lending institutions are required to enforce the requirement and aggregate data on properties subject to that requirement do not exist.

Premiums. Most properties, about 80 percent, are charged a premium based on FEMA's estimate of the expected cost to insure those properties against damages caused by flooding, what CBO calls actuarial premiums. The remaining 20 percent of NFIP insured properties are charged premiums that are lower than the expected cost of flood damage, what CBO calls subsidized premiums. In 2016, collections from actuarial and subsidized premiums totaled about $3.5 billion. In 2017, the average NFIP premium for commercial properties is about $2,400.

Additional Collections. All NFIP policyholders also pay a Reserve Fund Assessment (RFA) equal to 15 percent of their premium and a surcharge equal to $25 for policies that cover primary residences and $250 for policies that cover nonprimary residences or commercial properties. Both the RFA and surcharge are deposited into the NFIP Reserve Fund and are available to pay policyholder claims if amounts in the NFIF are insufficient. In 2016, a total of $919 million was deposited into the Reserve Fund. In 2017, the average RFA and surcharge was about $600 for commercial properties.

Reinsurance. The NFIP is also authorized to purchase reinsurance from private reinsurance or capital markets. Reinsurance is a mechanism by which a primary insurer, like the NFIP, can guard against catastrophic losses by paying a premium to one or multiple private entities that then assume the liability to pay certain claims at an agreed upon level of losses. In 2017, the NFIP purchased about $1 billion of reinsurance for a single flood with insurable claims between $4 billion and $8 billion. The NFIP paid a premium of $150 million for that reinsurance and the coverage will last through January 1, 2018.

Direct Spending

The bill would eliminate the requirement to buy flood insurance for commercial properties located in an SFHA and would require FEMA to purchase reinsurance in the private market.

Commercial Property. Using a database of NFIP policy information, CBO estimates that in 2017 there are approximately 230,000 commercial structures in SFHAs with NFIP policies, of which 40 percent pay subsidized premiums. FEMA does not track which NFIP insured properties are subject to that mandatory purchase requirement, but CBO expects the majority (about 75 percent) of those properties have a loan from a federally regulated lending institution. Thus, CBO estimates that in 2017 approximately 170,000 commercial properties are subject to the requirement to purchase flood insurance.

In 2014, the Government Accountability Office (GAO) reported that many property owners do not recognize the potential damage that may be caused to their property by a flood and underestimate the risk of a flood to their property.[1] While CBO cannot determine how many commercial properties subject to the mandatory purchase requirement have NFIP coverage solely because they are required to, we expect that many such property owners underestimate their flood risk. Owners of commercial property face NFIP premiums and fees that average about $3,000 per year. CBO expects that within a few years about half of the owners of commercial properties currently subject to the mandatory purchase requirement would discontinue buying flood insurance under H.R. 2246. CBO is unaware of any empirical information about the propensity of individuals to drop mandated insurance requirements when given the opportunity. However, because many property owners underestimate the risks they face from flooding, CBO expects that a significant number of commercial policyholders would gradually drop coverage if they were not required to have it.

Based on an analysis of information provided by FEMA on the premiums, surcharges, other assessments paid by commercial property owners, and the expected cost to insure them, CBO estimates that enacting this provision would increase net direct spending by $325 million over the 2018-2027 period from the loss of RFA and surcharge collections from commercial properties that would have been paying actuarial premiums. That decrease in collections would be partially offset by fewer claims resulting from fewer policyholders. Subsidized policy holders that elected to drop NFIP coverage would reduce net spending because the expected cost of those policies is greater than the premiums paid for the coverage.

CBO's estimated costs are uncertain and costs could be significantly greater or smaller than we have estimated. CBO is confident that some commercial property policyholders would drop NFIP coverage under H.R. 2246 at a net cost to the program. However, without basic information about which policyholders are required to maintain coverage, this estimate has a wide range of uncertainty.

Reinsurance. Section 3 of H.R. 2246 would require the NFIP to transfer a portion of the program's risk to private reinsurance or capital markets at least once per year in a manner that would ensure that enough funds are in the NFIF to cover claims in a typical year. Under current law, FEMA plans to purchase additional reinsurance for the NFIP after the expiration of the current coverage in 2018. Because FEMA intends to continue purchasing reinsurance in future years, CBO estimates that enacting this provision would have no significant effect the amount of reinsurance coverage the agency buys or on NFIP spending.

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1. See Government Accountability Office, Overview of GAO's Past Work on the National Flood Insurance Programs (May 2014).

Spending Subject to Appropriation

Section 4 of H.R. 2246 would direct FEMA to create standards and requirements for states and localities that choose to develop alternative maps to the Flood Insurance Rate Maps created by FEMA. The section also would require FEMA to determine within six months of receiving any proposed alternative maps from states or localities whether to approve such maps for NFIP rate setting purposes.

Based on an analysis of information provided by FEMA, CBO estimates that implementing this section would cost $1 million in 2018 to establish administrative procedures to review and approve community flood maps and $10 million each year thereafter to review, analyze, and make a determination on community flood maps that would be submitted by local jurisdictions around the country. Such spending would be subject to appropriation. In 2017, $178 million was appropriated for FEMA's flood mapping and related activities.

PAY-AS-YOU-GO CONSIDERATIONS

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays that are subject to those pay-as-you-go procedures are shown in the following table.

CBO Estimate of Pay-As-You-Go Effects for H.R. 2246, as ordered reported by the House Committee on Financial Services on June 21, 2017

	By Fiscal Year, in Millions of Dollars												
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2017-2022	2017-2027
NET INCREASE IN THE DEFICIT													
Statutory Pay-As-You-Go Impact	0	5	5	15	30	40	40	45	45	50	50	95	325

INCREASE IN LONG-TERM DIRECT SPENDING AND DEFICITS

CBO estimates that enacting H.R. 2246 would not increase net direct spending or on-budget deficits by more than $5 billion in any of the four consecutive 10-year periods beginning in 2028.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 2246 contains no intergovernmental or private-sector mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

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