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Is the private flood market a viable alternative to the NFIP?

Private market flood insurance is not only viable—it's here now.

Private policies are currently accepted by every major mortgage lender, almost every regional mortgage lender and almost all community banks. Many states have enacted changes to promote private flood insurance, and thousands of independent agents are already selling private flood policies. More insurers now insure billions of dollars of property.

The door opened for the private flood market when Congress and FEMA's NFIP lost the confidence of the general public as a result of the claims handling fiascos following Hurricane Katrina and Superstorm Sandy. Front-page headlines and negative publicity from skyrocketing premiums caused by Biggert-Waters didn't help—in some areas of the country, real estate sales came to a near halt due solely to unaffordable flood insurance premiums. While subsequent legislation—namely the Homeowners Flood Insurance Affordability Act of 2014—rolled back some premium increases, the law currently in effect still requires FEMA to increase all premiums a minimum of 5% a year and up to 25% a year.

Private flood markets question FEMA's pricing. According to historical claims data through 2007, FEMA's best loss ratios applied to newer properties built in the highest-risk V zones, while the worst loss ratios applied to FEMA's lowest-cost Preferred Risk Policy.

But it's important to note that the private market is not ready to compete for all existing 5 million NFIP policies. Thousands of properties with multiple flood losses are categorized as severe repetitive loss properties. FEMA's rates for these properties are only slightly higher than properties that have never incurred a flood claim. The private market has no motivation to offer a competitively priced alternative for this group.

Congress continues to pick other winners and losers by legislating rates that FEMA charges based on politically acceptable public policy, not risk assessment. For example, many policy premiums are grandfathered, using rates in effect when the property was built rather than current rates. FEMA charges these properties, now known to be located in a higher-risk flood zone, rates consistent with lower-risk properties. The private market will not compete for policies that are knowingly inadequately priced.

On the other hand, Congress has dictated high surcharges on FEMA's pricing for commercial properties and secondary/non-primary residential properties. These groups are attractive target markets for private insurers. Ironically, some of these non-primary residences are not second homes owned by the wealthy, but rather homes rented by families who cannot afford to purchase their own home. The additional cost of the surcharged flood insurance premiums for this group passes on in the form of increased rent.

Private market opportunities exist for many more FEMA premiums that have doubled and tripled in cost in the past decade. In 2005, the NFIP premium for a $250,000 policy insuring a single family home built in 1974 with a basement cost $1,495. Today, that policy costs $3,410—or $4,922 if it is a non-primary residence.

Congress is currently considering new legislation to make private flood insurance an even better alternative. The new law would make it even easier for all lenders to accept private insurance and demand that FEMA recognize private flood insurance the same as NFIP flood insurance when defining continuous coverage.

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