

of its own. While subsidizing premiums has increased participation, it offers another helping of moral hazard because premiums charged don't reflect the real, actuarial risk of living in flood-prone areas. As a result, artificially cheap insurance has encouraged households and businesses to build or expand in areas where they historically had not (because of the high potential for personal financial loss) and transferred much of the financial risk to taxpayers.

This strategy worked for a while. Until 2003, the NFIP did a reasonably decent job of balancing the annual ledger of profits and losses despite the subsidies. But since then, major catastrophes—most of them coastal hurricanes—have put the program deeply in the red as more and more development was allowed along the coasts and near other water bodies, driving up damages when disasters hit. Once claims related to Hurricane Sandy are settled, the NFIP expects to have program debt—borrowed from the U.S. Treasury with permission from Congress—of about \$28 billion. The program has imposed surcharges on policies to buy down the debt, but it's not nearly enough given the size of the deficit and the recent frequency of disasters.

The Ninth District isn't hurricane territory, but it gets its share of subsidies. In fact, the percentage of subsidized policies is higher among most district states than the national average of 20 percent (see Chart 3), in part because many structures located in flood hazard areas were already built (and then grandfathered) when flood plain mapping and management went into effect in the 1970s. Only North Dakota, at 14 percent, has a lower share of subsidized policies among district states, and that is likely because the state has much higher participation overall in flood insurance.

Make them pay

Thanks to these colliding trends—low participation, high subsidies, steep program debt—significant change is afloat for flood insurance, especially for those with subsidized policies. In late 2012, Congress passed the Biggert-Waters Flood Insurance Reform Act in hopes of eliminating the moral hazard of artificially low flood insurance costs and putting the NFIP on a sustainable financial path. It does so by eliminating subsidies for flood insurance and dramatically increasing premiums for policies in high-risk areas to reflect true flood risk.

Biggert-Waters provisions won't all happen at once, and there are a lot of quirks to the law, so its full effect will likely come in waves—some small, others larger. For example, though passed more than a year ago, the first major changes legislated by Biggert-Waters are just now taking root.

This past summer, subsidized rates for nonprimary residences, secondary residences, businesses and repetitive-loss properties were phased out, and subsidies for some other, targeted types of properties were eliminated in October. This will affect roughly 438,000 flood insurance policies, or one-third of all subsidized flood insurance policies nationwide. In the Ninth District, the initial implementation of Biggert-Waters is expected to impact more than 5,000 property owners, or about one-third of the 16,000 subsidized policies in the district, according to data and calculations from the NFIP and the Government Accounting Office.

To help with the financial adjustment for these properties, premiums for existing subsidized policies will be gradually raised, with annual increases capped at 25 percent until rates reflect actuarial risk, which FEMA believes could take more than five years for some properties.

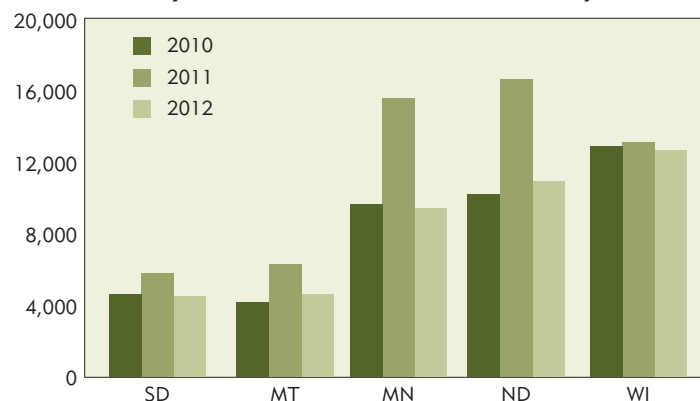
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The little state that could (flood)

Two states drive the broader trend of flood insurance policies in the Ninth District. Ironically, one of them is the smallest district state by population.

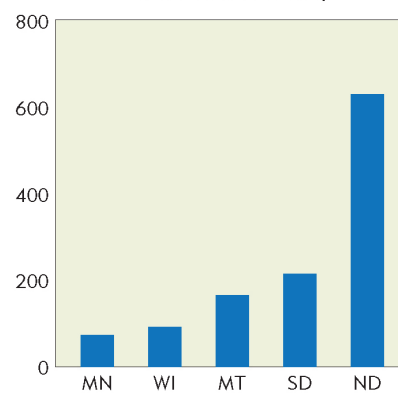
North Dakota ranks second among district states in the number of flood insurance policies in force, but has easily the highest concentration of flood insurance policies on a per household basis (see Charts 1 and 2). The Red River Valley is responsible for a large share of flood insurance policies. The valley is home to two of the state's largest cities (Fargo and Grand Forks) and more than half of the state's flood insurance policies because of the valley's exceptionally flat topography, which produces wide-reaching floods. Still, the state's comparatively high number of flood insurance policies equals just 6 percent of all single-family structures (an artificially high rate because some policies in force also cover small business and other nonresidential structures)

Chart 1
Flood insurance policies in force by state, December of each year



Source: National Flood Insurance Program

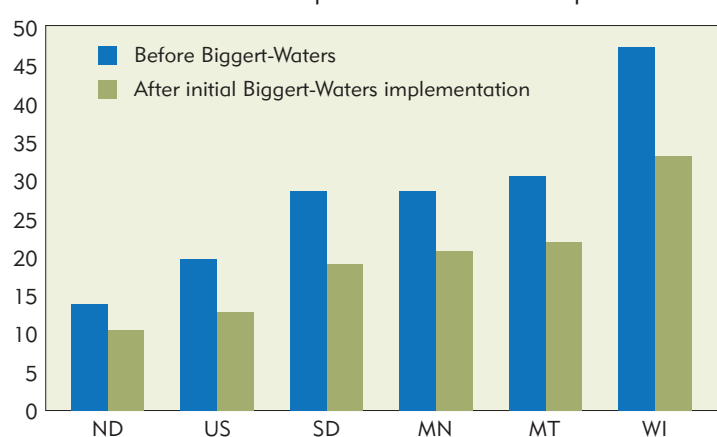
Chart 2
Flood insurance policies per 10,000 single-family structures (detached, attached and mobile homes)



Sources: National Flood Insurance Program, U.S. Census Bureau

North Dakota and Minnesota are responsible for the lion's share of volatility in flood policies from 2010 to 2012 (see Chart 1). Montana and South Dakota saw somewhat smaller changes in annual policies and have significantly fewer policies. Wisconsin has the largest number of flood insurance policies among district states—a function of the state's larger population and large number of water bodies in that state. But it saw none of the volatility in policies in 2011 because the state experienced little of the flood threat seen in nearby states that year.

Chart 3
Help from Uncle Sam
% of flood insurance policies with subsidized premiums



Sources: National Flood Insurance Program, Government Accountability Office