U.S. Department of Homeland Security
500 C Street, SW
Washington, DC 20472

FEMA

September 11, 2009

Jennifer J. Johnson, Secretary
Loans in Areas Having Special Flood Hazards
Interagency Questions and Answers Regarding Flood Insurance
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Board Docket Number R-1311.
Interagency Questions and Answers Regarding Flood Insurance

Dear Ms. Johnson:

The Department of Homeland Security, Federal Emergency Management Agency (FEMA) thanks the Agencies for this opportunity to comment on the final revisions to the Interagency Questions and Answers Regarding Flood Insurance, as well as on the six questions that are open for public comment. FEMA cannot agree with portions of the Questions and Answers and this letter and enclosed comments will reinforce statements that have been made during meetings with the Agencies and in previous documents. Thank you also for including this letter and the enclosed comments in the public record.

FEMA appreciates the extensive efforts undertaken by the Agencies on behalf of the lending community in order to expand these Questions and Answers. However, the enclosed comments detail FEMA concerns. Of particular concern are the two issues listed below requiring clarification by the Agencies.

First, FEMA believes that the Agencies' described use of the Standard Flood Hazard Determination form is ambiguous, and therefore, problematic to the lending industry and to the impacted borrowers.

Second, FEMA notes that in consultation with the Agencies, FEMA determined it would allow the lender and property owner, for the unknown number of low-value non-residential buildings in just the specific class of ranch, farming and industrial buildings, to calculate its own functional building valuation or cost of demolition and removal, without increasing the premium structure. All parties assume that only a small number of such buildings exist, and that the negative impact to the National Flood Insurance Program (NFIP) rating structure will be negligible. However, FEMA reserves its right to reverse its decision regarding the rating structure, if this approach proves to be detrimental to the Program. Additional issues may be revealed that make recalling this option prudent.

I trust the enclosed comments are helpful to you in finalizing your guidance document. If you need additional information or assistance, please feel free to contact Tuula Young, Lender Compliance Officer, by telephone at (202) 212-4729.

Sincerely,

Edward L. Connor
Acting Federal Insurance Administrator
National Flood Insurance Program

EC: ty

Enclosure

Board Docket Number R-1311

Part I: FEMA comments to Agencies Soliciting Comments concerning the "final" revisions to the Interagency Questions and Answers Regarding Flood Insurance released July 21, 2009

Question 66: May a lender provide the SFHDF to the borrower?
FEMA disagrees with the Agencies' comments that the SFHDF use is only for the lender in order to identify "if" the collateral is in a SFHA and is not required by statute to be given to the borrower.

The SFHDF is a FEMA form which may not be unilaterally amended by any entity in order to restrict its use. Moreover, the form is intended by the Act for use by the borrower. The excerpt below from the August 2, 1994 Congressional Record (House) (Congressional Record, August 2, 1994, HR6695) underscores this point.

"Section 528. Standard hazard determination forms. The conferees recognize and intend that the guarantees for third party information in this provision are adequate to **protect the interests of the borrower** [emphasis added] and to ensure the quality of the information provided by the third party. Since the lender is relying on the guarantees in order to ensure compliance with the mandatory flood insurance purchase requirements, lenders have ample incentives to ensure that the guarantees are adequate to protect the lender." (The first two parties are the lender and the borrower, and the 'third party' referenced here is the flood zone determination company).

Additionally, the SFHDF has several purposes, which require consistent release of the completed SFHDF by the lender to the borrower in order to disclose the type of flood risk zone. First, it provides standard documentation for federally regulated lending institutions that must identify the type of flood risk zone applicable to its collateral. If the collateral is identified as located in a high-risk flood zone, where flood insurance is available under the National Flood Insurance Act of 1968, such identification, as documented on the form, triggers a flood insurance requirement. Lenders must notify the borrower and require the purchase of flood insurance as a condition of granting a loan. Second, the SFHDF facilitates accurate rating of the borrower's flood insurance policy by the insurance agent. A lender's failure to provide the borrower a completed copy of the SFHDF early in the loan process, in time to facilitate the purchase of the required flood insurance policy, complicates compliance and places unnecessary costs upon the borrower. Third, per 44 CFR Section 65.17, the SFHDF is required documentation for a Letter of Determination Review (LODR) request by a borrower who wants to appeal the lender's determination. Fourth, the SFHDF notifies the borrower of the type of flood risk zone to which the building is exposed and enables the borrower to make informed decisions regarding voluntary purchase of flood insurance.

The borrower is entitled to a copy of the completed SFHDF because it impacts his/her property and the fee for a lender to obtain a flood zone determination recorded on the SFHDF is passed on to the borrower.

Question 71: What should a lender do when there is a discrepancy between the flood hazard zone designation on the flood determination form and the flood insurance policy?

Despite the Agency explanation that: "if the flood insurance policy shows a lower risk zone than the SFHDF, then the lender should investigate", lenders are asking FEMA for a clarification. FEMA suggests that the Agencies provide an example.

In the next paragraph, the following sentence needs to be changed: "The Grandfather Rule allows policyholders who have maintained continuous coverage and/or who have built in compliance with the Flood Insurance Rate Map to continue to benefit from the prior, more favorable rating for the particular pieces of improved property." Please revise to read, "*The Grandfather Rule allows policyholders who have maintained continuous coverage and/or have built in compliance with the Flood Insurance Rate Map to continue to have their flood insurance premiums rated based on the old map zone and Base Flood Elevations, if it is to his/her benefit*".

Question 80: Is use of the sample form of notice mandatory?

The Agencies failed to include FEMA's requested explanation for creating two sample forms for its September 2007 edition of the Mandatory Purchase of Flood Insurance Guidelines booklet. These sample forms, on page 4-4 to page 4-7 in Appendix 4, for an NFIP participating and a non-participating community assist in more fully explaining the implications to the borrower. Both samples include a toll free number to a FEMA mapping specialist in order that a consumer may have easy access to mapping information and/or the available options to appeal a lender's determination. The implications in a non-participating community, that no federal financial assistance is available, are more easily apparent to a consumer with the use of a separate form. The sample for a participating community has a clarified explanation of the minimum amount of flood insurance that must at least be required. Page 4-4 refers the lender to the Condominium section of the guidelines when the security is a residential condominium unit, as such a detailed explanation would not fit one sample form.

In the final revisions, the Agencies noted that (FEMA's) sample form includes other information in addition to what is required by the Act and the Regulation. FEMA notes that the FEMA Administrator has authority under the Section 4104a Notice Requirements, Section 527 of the 1994 Act, to include any other information considered necessary to carry out the purposes of the National Flood Insurance Program. For these reasons, the Agencies should expand the answer to Question 80 so that lenders understand and utilize both sample forms developed by FEMA.

Part II: FEMA's comments concerning the five questions "open for comment" until September 21, 2009.

FEMA requires the language in bold italics be added to questions 9 and 10, as it appears below, as a condition for FEMA to offer this coverage option:

Question 9: What is the insurable value of a building?

Answer: Per FEMA guidelines, the insurable value of a building is the same as 100 percent replacement cost value of the insured building. FEMA's *Mandatory*

Purchase of Flood Insurance Guidelines defines replacement cost as "The cost to replace property with the same kind of material and construction without deduction for depreciation."
When determining replacement cost value of a building, lenders (either by themselves or in consultation with the flood insurance provider or other professionals) should consider the replacement cost value (RCV) used in a hazard insurance policy (recognizing that replacement cost for flood insurance will include the foundation), an appraisal based on a cost-value approach before depreciation deductions (not a market value), and/or a construction cost calculation.

In considering the comments submitted on the subject of insurable value, the Agencies recognized that there are situations when insuring some ***low value*** nonresidential buildings at RCV would result in the building being over-insured. The Agencies, in consultation with FEMA, are proposing two ***additional*** alternatives to determine replacement cost value for ***low value*** nonresidential buildings used for ranching, farming, or industrial purposes, which the borrower either would not replace if damaged or destroyed by a flood or would replace with a structure more closely aligned to the function the building is providing at the time of the flood. Industrial use, as opposed to the broader commercial use, is defined as those buildings not directly engaged in the retail and/or wholesale sale of the business's goods, such as warehouses or storage, manufacturing, or maintenance facilities.

FEMA has determined it would allow the lender and property owner, for this unknown number of low value buildings in this specific class of buildings such as ranch, farming and industrial buildings to come up with its own functional building valuation or cost of demolition and removal, without increasing the premium structure. All parties agree that only a small number of such buildings exist and the negative impact to the NFIP rating structure will be negligible. However, FEMA reserves its right to reverse its decision regarding the rating structure if this approach proves to be detrimental to the Program. Additional issues may be revealed that make recalling this option prudent.

The first alternative is the "functional building cost value," which is the cost to repair or replace a ***low value non-residential*** building with commonly used, less costly construction materials and methods that are functionally equivalent to obsolete, antique or custom construction materials and methods used in the original construction of the building. Borrowers and/or lenders can choose this alternative when the building being insured is important to the business operation and would be replaced if damaged or destroyed by a flood, but not to its original condition. The "functional building cost value" recognizes that insurance to the replacement cost is not needed as the borrower would not repair or replace the ***low value non-residential*** building back to its original form but to a condition that represents the function the building is providing to the business operation.

The second alternative is the "demolition/removal cost value," which is the cost to demolish the remaining structure and remove the debris after a flood. Borrowers and/or lenders can choose this alternative when the ***low value*** building being insured is not important to the business operation and would not be repaired or replaced if damaged or destroyed by a flood. The "demolition/removal cost value" recognizes that the building has limited-to no-value and that it does not provide an important enough function to necessitate that the business repair or replace it.

When a borrower or lender chooses one of these two replacement cost value alternatives they have determined that the building to be insured will not be insured to its full replacement cost value. Both the borrower and the lender should ensure that they consider the impact this may have on the ongoing nature of the business and the value of the collateral securing the loan. Full replacement cost is always the preferred insurance amount. These ***additional*** alternatives are available only for those situations where full replacement cost would result in a building used for farming, ranching, or industrial purposes being over-insured. The Agencies are proposing new question and answer 10 to address this issue.

<u>Questions 10: Are there alternative approaches to determining the insurable value of a building?</u>
Answer: Yes, in the case of ***low-value non-residential*** buildings used for ranching, farming, and industrial purposes, insurable value may also be determined by the functional building cost value or the demolition/removal cost value. The Agencies recognize that there are situations where insuring some nonresidential buildings to the replacement cost value will result in the building being over-insured. Therefore, borrowers and/or lenders have two ***additional*** alternative approaches to determine the insurable value for ***low value*** buildings used in ranch, farming, and for industrial purposes when the borrower would either not replace the building if damaged or destroyed by a flood or would replace the building with a structure more closely aligned with the function the building is presently providing. Industrial use, as opposed to the broader commercial use, means those buildings not directly engaged in the retail and/or wholesale sale of the business's goods, such as warehouses, storage, manufacturing, or maintenance facilities.

The lender may calculate the insurable value as the "functional building cost value," that is, the cost to replace a ***low value non-residential*** building with a lower-cost functional equivalent. The "functional building cost value" is the cost to repair or replace a ***low value non-residential*** building with commonly used, less costly construction materials and methods that are functionally equivalent to obsolete, antique, or custom construction materials and methods used in the original construction of the building. The determination of the appropriate "functional building cost value" amount of insurance should be made by the lender and/or borrower. This alternative may be chosen when the
building is important to the ongoing nature of the business and would be replaced if damaged or destroyed in a flood, but not to its original form, ***to lower-cost functional equivalent.*** For example, a farming operation would replace an old dairy barn currently used for storage with a storage building of pole, or some other type of less costly construction found currently in storage buildings. The lender may calculate the insurable value as the "demolition/removal cost value," that is the cost to demolish the remaining structure and remove the debris. The "demolition/removal cost value" may be used when a ***low value non-residential*** building is not important to the ongoing nature of the business and as such would not be replaced if damaged or destroyed by a flood. The amount of flood insurance should be calculated by the lender and/or borrower to be at least the cost of demolition and removal of the insured debris. Regardless of what method the lender and/or borrower selects to determine insurable value (replacement cost value or one of the two alternatives), all terms and conditions of the Standard Flood Insurance Policy apply including its Loss Settlement provision.

<u>Question 60: Can the 45-day notice period be accelerated by sending notice to the borrower prior to the actual date of expiration of flood insurance coverage?</u> FEMA believes that the response

should be no, notice is to be made upon discovery that the borrower's policy has lapsed or is inadequate.

The Agencies should make a distinction between the flood insurance policy, purchased by the borrower as a condition of the loan, and the lender placed flood insurance policy coming up for renewal. The Agencies have not addressed the situation where the lender placed non-NFIP policy is about to expire as to whether notice is required. FEMA suggests Agencies take this opportunity to do so

Question 61: Is a reasonable period of time allowed after the end of the 45-day notice period for a lender or its servicer to implement force placement? FEMA believes that force placement should occur on or after the 46th day. FEMA recommends the Agencies note that force placement is not an option at loan origination and that borrowers should have purchased flood insurance by the closing date.

Question 62: Does a lender or its servicer have the authority to charge a borrower for the cost of insurance coverage during the 45-day notice period? FEMA believes the response should be no. Gaps in coverage and costly administration of the notice requirements would be eliminated if lenders adopt the practice of escrowing flood insurance premiums even when not required by law.