What GAO Found

While it constitutes a declining percentage of all NFIP policies, the number of properties receiving subsidized premium rates has grown since 1985; by 2007 it was at its highest point in almost 30 years. According to FEMA, this growth resulted from several factors, including a growing number of mortgages with mandatory flood insurance purchase requirements and greater enforcement of these requirements, the longer-than-expected life of the structures that are eligible for subsidies, and increased awareness of the dangers of floods from several major recent disasters and increased NFIP marketing efforts. To date, more than half of the subsidized policies are concentrated in five states with relatively high flood risk—California, Florida, Louisiana, New Jersey, and Texas. Current low participation rates—around 50 percent of single-family homes in high-risk areas—leave room for substantial growth in the number of NFIP policies, many of which would be likely to receive subsidized rates. Because of their relatively high loss experience and lower premium rates, the policies receiving subsidized rates have been a financial burden on the program, with total claims exceeding premiums by $962 million over the period from 1986 through 2004, before the large losses from the 2005 hurricanes. Without changes to the program, the number of subsidized properties will likely continue to grow, increasing the potential for future NFIP operating deficits.

As Congress evaluates the impact of subsidized premium rates, it is faced with balancing the public policy goals of charging premium rates that fully reflect actual risks, encouraging broad program participation through affordable rates, and limiting costs to taxpayers. While the current program of property-based subsidies and voluntary mitigation efforts—steps taken to reduce a property’s flood risk such as relocation or elevation—encourages broad program participation, it is unlikely to substantially reduce the adverse financial impact of subsidized properties. GAO identified three options for addressing the financial impact of subsidized properties on the NFIP, each with advantages and disadvantages. One option would be to increase mitigation efforts, including making mitigation mandatory. Mitigation could help reduce flood losses, but the increased funding for such efforts could be high. A second option, eliminating or reducing subsidies, could improve NFIP’s financial stability by increasing the number of policies that more accurately reflect the risk of flooding. However, the resulting higher premium rates could reduce NFIP participation and could meet resistance from local communities. A third option would be to target subsidies based on financial need, which could help ensure that only those in need receive subsidies, with the rest paying full-risk rates. However, it could be challenging for FEMA to develop and administer such a program in the midst of ongoing management challenges. While the inherent difficulty in determining premium rates adequate to cover potentially volatile and at times catastrophic flood losses means that the potential for the program to incur future operating deficits will always exist, implementing any or a combination of these options could significantly reduce the adverse financial impact of subsidies on NFIP.