KRIEG DEVAULT

Insights

September/October Hoosier Banker: Covering Your Losses With Flood Certifications

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While federally regulated lenders are typically aware of the requirement under the Flood Disaster Protection Act of 1973[1] (the "Act") to obtain flood certifications upon making a loan, lenders failing to update flood certifications when they increase, modify or renew a loan may find their collateral and loans underwater.

Background

With floods being the most common and costly natural disaster in the United States,[2] the Act requires lenders to obtain flood certification for loans secured by improved real estate or a mobile home stating the flood zone status of the property.[3] The Federal Emergency Management Agency designates flood zones based on a Flood Insurance Study.[4] FEMA updates the study annually, but not comprehensively.[5] FEMA prioritizes locations where real estate development is greatest, and where the maps are most outdated.[6] Map updates also may be initiated by affected communities.[7] Thus, a lender cannot assume that a particular flood designation has remained unchanged over the life of a loan.

If any part of the improved real estate or mobile home lies in a flood hazard area, then the entire structure must be covered by flood insurance.[8] Lenders must document their flood hazard results using FEMA's form and retain a copy throughout the term of the loan.[9] If property is located in a Special Flood Hazard Area, the borrower must obtain flood insurance through either the National Flood Insurance Program or private flood insurance.[10]

Best Practices

Lenders should implement monitoring and tracking systems to prevent uninsured flood loss throughout the term of the loan, from inception to any increases, renewals or extensions. A best practice, commonly followed, is to monitor the expiration dates of flood policies; to provide required notices to borrowers; and to force place insurance, if necessary.[11]

Another best practice, but not as commonly followed, is to periodically review updates to the flood maps for the life of the loan. Many lenders file away the flood certification, then forget about it. Although lenders generally are not required to monitor flood maps on existing loans, if the lender increases, extends or renews the loan, or has knowledge or reason to know of the need for flood insurance coverage, then the lender must review or renew its flood certification and cannot automatically rely on the original flood determination, *unless* three conditions are satisfied:

1. The prior determination was made within seven years of the new transaction;
2. FEMA has not updated the applicable flood map since the lender's original determination; and
3. The Standard Flood Hazard Determination Form reflects the basis of the determination.[12]

Even if a prior determination is less than seven years old, a lender still must check to see if the flood map has changed. Fortunately, the most recent flood map updates for particular addresses are easily viewable on FEMA's website.[13]

Additionally, flood hazard determination companies offer "life-of-loan coverage," through which they will notify the lender of flood map changes.[14] Working with such a provider can give added protection in alleviating potential problems.

In short, lenders may prevent uninsured flood losses by following these practice tips to maintain and update flood certifications.

1 42 U.S.C. § 4003; 42 U.S.C. § 4011 et. seq.

2 Federal Emergency Management Agency, National Flood Insurance Program Fact Sheet (2011), www.fema.gov/pdf/media/factsheets/2011/mit_natl_flood_ins.pdf.

3 42 U.S.C. § 4012a(b). Proposed legislation seeks to repeal mandatory flood insurance coverage for commercial properties located in flood hazard areas. See H.R. 2246, 115th Cong. (2017-2018). However, this legislation, known as the Taxpayer Exposure Mitigation Act of 2017, provides that FEMA may not prohibit or limit the purchase of flood insurance coverage under the National Flood Insurance Program for eligible commercial properties. Id. Although the House Financial Services Committee sent the bill to the full chamber for consideration on June 21, 2017, H.R. 2246 has been given a low chance of passing. See Taxpayer Exposure Mitigation Act of 2017, H.R. 2246, 115th Cong. (2017-2018), www.govtrack.us/congress/bills/115/hr2246.

4 Practical Law Real Estate, Property and Liability Insurance in Real Estate Transactions, THOMSON REUTERS (2017).

5 FEMA, Flood Map Revision Processes (2017), www.fema.gov/flood-map-revision-processes.

6 Id.

7 See id.

8 FIS Regulatory Advisory Services, Compliance Manual, §4.29 (2010).

9 12 C.F.R. § 208.25(f)(2).

10 Practical Law Real Estate, Property and Liability Insurance in Real Estate Transactions, THOMSON REUTERS, 2017.

11 12 C.F.R. § 208.25(g)(1).

[12] 42 U.S.C. § 4104b(e).

[13] FEMA Flood Map Service Center: Welcome!, FEMA, https://msc.fema.gov/portal.

[14] FIS Regulatory Advisory Services, Compliance Manual, §4.29 (2010). To offset the cost of this monitoring, lenders are permitted to charge the borrower. See 12 C.F.R. § 208.25(h)(1).