

Insights

Covering Your Losses With Flood Certifications ‐ It's Not Just Common Sense, IT'S THE LAW!

July 23, 2017

While federally regulated lenders are typically aware of their responsibilities under the Flood Disaster Protection Act of 1973 (the "Act") to obtain flood certifications upon an initial extension of credit, lenders that fail to maintain and update flood certifications upon loan modifications or renewals may find their collateral and their loans underwater.

Background on Flood Certifications

The Federal Emergency Management Agency (FEMA) has observed that "Floods are the most common and costly natural disaster in the United States." Due to the prevalence of floods in the United States, the Act mandates flood insurance in designated areas to protect lenders and borrowers against uninsured flood losses. Under the Act, regulated lenders are required to obtain a flood certification not only when initially making, but also when increasing, extending or renewing a loan secured by improved real estate or mobile homes.

A flood certification is a document that states the flood zone status of real property. FEMA designates flood zones based on a Flood Insurance Study (the "Study"). The Study is updated annually on FEMA's initiative, but the update is not comprehensive. Due to funding constraints, FEMA prioritizes study and restudy needs based on a cost-benefit approach and gives highest priority to studies in locations where real estate development is greatest and where the maps are most outdated. Sometimes map updates are initiated by the affected communities. Thus, a lender cannot assume that the flood designation of particular real estate has remained unchanged over the life of a loan.

If a lender determines that 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. Regulated lenders must document their flood hazard results using FEMA's form and must retain a copy of this form throughout the term of the loan. If property is located in a Special Flood Hazard Area, the borrower must obtain flood insurance through either: (1) the NFIP; or (2) private flood insurance.

Best Practices for Maintaining Flood Certifications

Regulated lenders are encouraged to implement monitoring systems to prevent uninsured flood losses, not only upon the initial making of the loan, but throughout its term, including any increases, renewals or extensions.

A best and commonly followed practice is to monitor the maturity dates of loans secured by collateral required to be covered by flood insurance. If a lender determines: (1) that an existing loan is in a Special Flood Hazard Area; (2) that the borrower has procured flood insurance in an amount less than the amount required for coverage; or (3) that coverage has expired, the lender is required to notify the borrower within a reasonable time of the borrower's deficient flood insurance coverage. In this communication, the lender must notify the borrower of its need to obtain flood insurance in an amount specified for the remaining term of the loan. If the borrower does not obtain flood insurance within 45 days, the lender is required to force-place flood insurance on the borrower's property and may charge the borrower for the cost of premiums and fees to obtain coverage.

In the Interagency Questions and Answers Regarding Flood Insurance, the agencies provided guidance on when forced-placed insurance must be made effective. Specifically, Q&A 61 provides that a lender should have insurance in effect on the day after the expiration of the 45-day notice period. Nevertheless, the agencies acknowledge that placing insurance effective on the 46th day is not always possible. If a lender is delayed in force-placing flood insurance, the agencies expect the lender to be able to provide a reasonable explanation for the delay. Based on this information, lenders must document when they notified borrowers of their deficient flood insurance and the time the 45-day period ends. Lenders should not delay in force-placed flood insurance upon expiration of the 45-day period. If a lender does delay, it is best for the lender to have written documentation explaining the cause of the delay.

Another best, but not as commonly followed, practice is to periodically review updates made to the Special Flood Hazard Area maps for the life of the loan. Many lenders place the flood certification in the file and that is the last attention given to it. Although lenders are generally not required to monitor flood maps on their existing improved real-estate secured loan portfolio, 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 simply rely on the initial flood determination. A lender may rely on its own prior flood certification determination only if three conditions are satisfied: (1) the prior determination was made within seven years of the date of the new transaction; (2) FEMA has not revised or updated the flood maps since the original determination was made; and (3) the Standard Flood Hazard Determination Form reflects the basis of the determination.

Of course, even if a prior determination is less than seven years old, a Lender still must check to see if the flood maps have changed. Fortunately, Lenders can easily review the most recent updates to flood maps for particular addresses on FEMA's website (*FEMA Flood Map Service Center: Welcome!*, FEMA, <https://msc.fema.gov/portal>). Additionally, many companies offer "life-of-loan coverage" where the company will notify the lender if a flood map changes. To offset the cost of this monitoring, lenders are permitted to charge the borrower the costs of these services.

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

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