U.S. faces $20 billion flood-insurance debt

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Barely noticed in the clamor over the financial industry bailout, a multibillion-dollar rescue operation is under way in Washington to keep one of the world's largest insurers afloat.

The foundering giant is the federal government's own National Flood Insurance Program, which is $17.3 billion in debt to the U.S. Treasury. When the bills for Hurricanes Gustav, Hanna and Ike are added up, probably by year's end, the program will likely be in the red by more than $20 billion - with virtually no chance of paying it back.

For the last two years, Congress searched for ways to fix the NFIP, which holds $1.1 trillion in policies on some of the highest-risk real estate in the country. The 40-year-old program was due to expire at the end of last month, but the House and Senate were still so far apart on legislative remedies that they decided just to reauthorize the program as-is through March 6.

So, left to the next president and the next Congress to resolve are the same chronic quandaries: how to build up cash reserves, what to do about properties that are repeatedly damaged, how to erase the enormous debt, which amounts to about $160 per U.S. household.

According to a Senate estimate, annual interest alone on the NFIP's debt is about $900 million - more than 30 percent of the $2.9 billion in premiums collected last year.

"We're glad to have this extension," said Butch Kinerney, a spokesman for the Federal Emergency Management Agency, which runs the NFIP. "We didn't want to get into a situation where we ended up not being able to write policies."

Unlike private insurers, the NFIP was set up without reserves. Instead, the Treasury has stood behind the losses. The NFIP currently is allowed to borrow up to $20.8 billion from the Treasury. But the program might have to ask for more, Kinerney said, estimating that total payouts for the 2008 hurricane season could end up between $3 billion and $6 billion.

While the NFIP debt may seem paltry compared with the $700 billion cost of shoring up the nation's financial institutions, experts point to a fundamental difference between the two bailouts.

Taxpayers should recoup some of the $700 billion, but the flood-insurance money "is all down the tubes," said Eli Lerher of the Competitive Enterprise Institute, a research group in Washington.

The latest Senate version of a bill to right the listing NFIP would officially forgive the program's debt. The Senate also wants to build NFIP reserves and raise premiums on policies, some of which are offered at deep discounts.

The House has called for discounts to be phased out. But the most controversial provision in its bill would increase the NFIP's scope by adding wind damage to the available coverage.

Such diverse allies as the Bush administration, the National Wildlife Federation, and the insurance industry oppose the House bill. "It is potentially enormously expensive," said Robert Shapiro, a consultant who was an undersecretary of commerce in the Clinton administration, "and no one expects the premiums would reflect that."

Shapiro and others argue that covering wind damage would be an invitation to disaster, considering the NFIP's vulnerability to losing money.

"In 40 years, we haven't got that right," said David R. Conrad, water resources specialist for the wildlife federation.

The biggest drain on the program continues to be properties that suffer repeated flooding. And not all of them are in Texas and Louisiana.

Both Pennsylvania and New Jersey - with close to 300,000 policies and coverage worth about $50 billion - rank among the top 10 states for total flood payouts.

Ironically, NFIP was created to save the taxpayers money. The government got into the flood insurance business, in June 1969, because the private sector wouldn't.

So residents could qualify for coverage, towns had to take anti-flooding measures and restrict building in high-risk areas. To set rates, the government undertook a massive mapping project to identify flood zones.

In theory, putting up safer buildings and making property owners pay for flood coverage should have cut down on disaster aid.

The program began operating in what weather experts say was a generally quiet hurricane period that lasted through the 1970s and '80s.

However, the 2005 hurricane season exposed all the program's flaws, notably the lack of reserves, badly dated maps, and subsidized rates.

The NFIP had been giving deep discounts - 60 percent to 65 percent of actuarial rates - to owners of older homes in floodplains to get them to join the program. For the 2005 season, the NFIP paid out more than $17 billion; of the properties filing claims for Katrina, Wilma and Rita, 60 percent were built before the 1970s.

The program was swamped, said David C. John, senior research fellow at the Heritage Foundation, a conservative Washington think tank. The NFIP, he said, "was not designed for a direct hit by a hurricane on the Gulf Coast."