

FLOOD INSURANCE – LIABILITY CONCERNS

The National Flood Insurance Program (“NFIP”) was instituted by Congress in 1968 with a noble goal of reducing the economic and social costs of floods. Unfortunately, the economic viability of the NFIP became a real issue, and all agreed that reform was necessary in order to assure the continued viability of the program. This resulted in the Biggert-Waters Flood Insurance Reform Act of 2012 (“Biggert-Waters”). The goal of this legislation was to restore the financial stability of the NFIP and require property owners in floodplains to assume the “true flood risk.” NAR supported the enactment of Biggert-Waters, as the continued availability of affordable flood insurance would directly impact REALTORS® who represented buyers and sellers in flood prone areas.

The Federal Emergency Management Agency (“FEMA”) administers the NFIP. The reforms in Biggert-Waters would generally measure risk based on the elevation of property as determined by FEMA. The rate increases caused by Biggert-Waters took effect on October 1, 2013. It cannot be denied that the rate increases caused by Biggert-Waters have substantially impacted some sellers’ ability to sell and some buyers’ ability to afford properties for which flood insurance is required, *i.e.*, property owners whose lenders require flood insurance through NFIP.

While the public usually associates the necessity for flood insurance with properties located on the coasts of the United States, there is no question that the changes caused by Biggert-Waters could also have a substantial impact on inland states, such as Michigan. According to the Michigan Department of Environmental Quality, as of April 3, 2013, there

were 27,925 flood insurance policies in the State of Michigan. These policies provide coverage in the amount of \$4,771,981. Further, since 1978, Michigan's citizens have received \$51,188,928 from the flood insurance fund.

NAR is currently working to delay or modify the immediate effects of Biggert-Waters in the form of increased flood insurance premiums under the NFIP. Neither NAR nor any other proponents of Biggert-Waters anticipated that FEMA would take action which would result in such dramatic increases for buyers of properties which require flood insurance. In the meantime, Michigan REALTORS® have sought guidance as to how to handle the sale and purchase of property which may be subject to dramatically increased flood insurance premiums.

REALTORS® Representing Sellers

There is no current statutory or common law obligation on REALTORS® representing sellers to determine whether a listed property is in a floodplain designated by FEMA or will otherwise require flood insurance through the NFIP if a buyer purchases the property.

The Michigan Seller's Disclosure Statement in item 11 under the heading "Property conditions, improvements & additional information" states as follows:

Flood Insurance: Do you have flood insurance on the property?

At the time of the original drafting of the Seller's Disclosure Statement, there was a debate as to whether the question posed to a seller should be "Is the property in a floodplain?" or "Do you have flood insurance?" The choice to ask about flood insurance was made on the basis that it seemed more likely that a seller would know if he or she had flood insurance because the requirement would be imposed on them by their lender under the NFIP. Due to the perceived

inaccuracy or vagueness of FEMA flood maps, there was a concern that sellers would innocently misrepresent that they were not within a floodplain based upon an inaccurate map or a misreading of a FEMA map. Obviously, with a potential for substantially increased rates to buyers, it is important that sellers carefully fill out this question on the Seller's Disclosure Statement. It should be noted that if sellers originally purchased their property for cash or have paid off a prior mortgage, they may not carry any flood insurance and could truthfully answer the question "no." This in turn could lead to an assumption by a buyer that the property is not within a floodplain and will require no flood insurance at any cost.

It would appear that the only source of potential liability for listing brokers in Michigan to buyers for a failure to advise of increased flood insurance premiums would arise under Michigan common law for fraud. Under Michigan law, a listing broker may be liable to a buyer if the following occurs: (1) the broker made a material representation to a buyer (*e.g.*, the property was not within a floodplain and does not require flood insurance); (2) the representation was false (*e.g.*, the property was within a floodplain and does require flood insurance); (3) the REALTOR® knew the representation was false when made or made the representation recklessly, without the knowledge of its truth and as a positive assertion (*e.g.*, the REALTOR® had looked at a FEMA map and saw whether the property was within a floodplain or, alternatively, never made any investigation and simply made the statement); (4) the representation was made by the REALTOR® with the intention that the buyer act in reliance upon it; (5) the buyer did act in reliance upon it; and (6) as a result, the buyer suffered injury (*i.e.*, bought a home with flood insurance premiums which were not affordable).

There are at least two reasons why these types of claims should rarely arise. First, there is absolutely no reason why a listing REALTOR® would or should make any representations to buyer with respect to a property being within a floodplain or being subject to a requirement for flood insurance through NFIP. Second, if as is typical, the buyers are financing the purchase of the property through a federally-insured lender, they would be advised before closing that flood insurance through the NFIP was required for the property. In other words, even if buyers claimed that the listing REALTOR® had told them that the property was not within a FEMA floodplain or did not require flood insurance, the buyers would discover the truth from their lender prior to closing. Obviously, this discovery would not occur in situations where a buyer is paying cash or the seller is financing the sale of the property through a land contract or purchase money mortgage.

REALTORS® Representing Buyers

Although there has not been sufficient time for any court to consider claims asserted by buyers against buyers' agents with respect to unanticipated and unaffordable flood premiums, the general concern among Michigan REALTORS® seems to be that a buyer will purchase a property and learn after closing that his or her required annual flood insurance premium is not the \$600.00 which was previously paid by the seller, but \$10,000. As indicated above, this would seem to be a highly unlikely event if the purchaser is financing the property through a lender who by law must require the flood insurance through NFIP if the property is within a floodplain. Nonetheless, there can be no argument that under Michigan law, a buyer's agent has a fiduciary duty to disclose all known material facts to a buyer.

Fortunately, there are a number of practical steps which can be taken by REALTORS® representing buyers to avoid any problems with unanticipated high flood insurance premiums. First, REALTORS® could amend their buyer agency agreements to include among the disclaimed items any knowledge of the location of the property within a floodplain or any requirement for flood insurance.

Second, REALTORS® should approach the issue of flood insurance in the same way they deal with the issue of the proximity of sex offenders. In the latter instance, REALTORS® have consistently been advised that they should inform buyers of the existence of the sex offender registry and that the buyers should consult that registry if they have a concern. The same is the case with regard to the potential location of a property within a floodplain as determined by FEMA. FEMA maintains the website <http://www.floodsmart.gov/floodsmart/>. This website contains a “One-Step Flood Risk Profile” which permits a user to insert the address of a property and obtain an immediate determination and receive a response: “THIS PROPERTY IS HIGH-RISK” and “You live in or near a Special Flood Hazard Area” (in which case flood insurance is a likely requirement) or “THIS PROPERTY IS MODERATE-TO-LOW RISK” (and there would be no required flood insurance). This site goes on to provide the names of insurance agents within the area of the property who can answer a buyer’s questions with respect to flood insurance. Obviously, REALTORS® representing buyers should direct those buyers to this website.

Conclusion

There seems to be no question that the increased insurance premiums under Bigger-Waters has and continues to cause concerns for REALTORS® who are selling properties in high-risk areas in Michigan. If REALTORS® take care in dealing with sellers and buyers on this issue, it will simply be an economic issue and not a legal liability issue.