

Selected Subjects

Guru Chatter*

on Flood Requirements



Flood Determinations: Can We Go For Two Out of Three?

Question: Two separate flood determination vendors were recently contacted to provide flood certification for the same tract of real estate. One responded no flood insurance required, the other, flood insurance *is* required. Can the bank choose between the two?

Answer by Dan Persfull:

No. You must determine which one is correct. Although you may rely on a third party for the determination, you are responsible for the accuracy.

1. Are they both using the same map number?
2. Is it possible a portion of the property is in a SFHA, but the structure is not?
3. Contact both vendors and let them know you have a discrepancy and ask them to re-verify their determination.
4. Go to FEMA's Map Store on their Web site and pull up the map and make your own comparison.

Mail Flood Insurance Notice Prior to Loan Closing

Question: When our flood determination shows property is located in a flood zone, we verbally notify our customer as soon as possible and then produce the Flood Insurance Notice at the time of closing on all our commercial loans. Are we required to mail this notice to our customer prior to closing?

Answer by Dan Persfull:

Yes.

NOTICE PROVISIONS OF THE STATUTE

Section 4104a Notice requirements (This section of the U.S. Code includes public law section 527 of the 1994 Reform Act)

(a) Notification of Special Flood Hazards

(1) Regulated lending institutions

Each Federal entity for lending regulation (after consultation and coordination with the Financial Institutions Examination Council) **shall by regulation require**

regulated lending institutions, as a condition of making, increasing, extending, or renewing any loan secured by improved real estate or a mobile home that the regulated lending institution determines is located or is to be located in an area that has been identified by the Director under this title or the Flood Disaster Protection Act of 1973 as an area having special flood hazards, **to notify the purchaser or lessee** (or obtain satisfactory assurances that the seller or lessor has notified the purchaser or lessee) and the servicer of the loan of such special flood hazards, **in writing, a reasonable period in advance of the signing of the purchase agreement, lease, or other documents involved in the transaction.** The regulations shall also require that the regulated lending institution retain a record of the receipt of the notices by the purchaser or lessee and the servicer.

Flood Zone, But Land Value Equals Loan

Question: I have a customer who requested a loan for \$9,000.00 secured by his personal home. The flood determination came back as the property being in flood hazard area. The value of the land on the property is \$9,000.00. My question is, does this customer need flood insurance on this loan since the value of the land is \$9,000 and the loan also is \$9,000.00?

Answer by Dan Persfull: Yes. From page 25 of the Mandatory Purchase of Flood Insurance Guidelines;

(5) Low-Value Building on High-Value Land

Lenders are sometimes confronted with a situation where a building is being used for residential or commercial purposes on land whose value alone would be sufficient to secure the loan without regard to the value of the building. In this situation, the 1994 Reform Act does not give a lender the option of enabling the borrower to avoid the purchase of flood insurance, even though the value of the land would provide more than adequate security for the amount of the loan, without taking into account the value of the building on the land.

Foreclosures and Flood Zone Properties

Question: For a designated loan, is a lender required to maintain flood insurance on the property after foreclosure? I guess the issue is, what is the definition of "life of loan"? What if the original flood cert demonstrated that the property was not in a flood zone, but after foreclosure, the new appraisal shows that the improvement is located in the flood zone? Is the lender under any duty at that point?

Answer by Dan Persfull:

Once the bank becomes the owner of the property a designated loan would no longer exist and the flood requirements would not apply. However, from a safety

and soundness perspective you may want to consider placing insurance on the property.

Force Placement of Flood Coverage On HELOC

Question: When force placing flood insurance on a HELOC, are we allowed to "charge" the borrower for the cost of the insurance by adding the amount to their HELOC balance (i.e., debiting their account) assuming, of course, that all appropriate disclosures and notices have been provided to them?

Answer by Dan Persfull: This will depend on your HELOC agreement and/or mortgage. Most will allow you to charge the premium to the account.

Paying Off Loan with Force Placed Flood Insurance

Question: Regarding force-placed insurance, if a loan pays off while still in a force-placed status and the policy is cancelled a short time after the payoff, is the premium due from the effective date to the payoff date or the date of cancellation? I live in the state of Florida.

Answer by Dan Persfull: I would discuss this with the entity that force places the insurance for you and also review the contract. In most cases the refunds are prorated from the effective date of the policy through the cancellation date (the property is covered until the cancellation date), however there could be an agreement, for force placed insurance, the premiums would be refundable as of the date of payoff. However, this could be risky for the insurance company if a loss occurred between the payoff date and the actual cancellation date.

Flood Regulations: Coverage at Closing

Question: What constitutes "coverage" per flood regulations at closing? We have a customer with an application and paid receipt but no policy. Is this enough or should the policy be in hand before closing?

Answer by Dan Persfull:

An application with a paid receipt will suffice as proof of coverage for closing purposes. However, you should have good follow-up procedures to insure that you receive the policy within 30 days. Also, don't let an agent throw the 30 day waiting period story at you. It does not apply when flood insurance is obtained in connection with a covered loan.

Too Much Flood Coverage Required

Question: I am financing a 200+ acre farm which has several barns, mobile homes and sheds, some of which are in the flood plain. The appraised value of the farm is \$2.2m and the loan amount is only \$750,000. Our compliance person

is requiring \$440,000 worth of flood insurance on the buildings of which not all are in the flood plain but because Flood Services has determined by the road address that the farm lies in the flood plain all have been included. Surely this can not be right?

Answer by Dan Persfull:

Only the buildings located, or partially located, within the floodplain have to be covered. You will have to be able to document which ones are and which ones are not and the only way I know to do that is to do a site survey with elevations.

Flood Insurance on a Charged Off Loan?

Question: If you have a loan that is in a flood zone and you charge this loan off do we still have to have flood insurance on it and if so does the bank pay for that or can the bank force place and charge to the loan for collection?

Answer by Jim Bedsole:

As far as I know, the charge off is simply an accounting recognition of the loan as a loss. It doesn't change its status as a loan for purposes of Flood insurance. The only thing that would do that would be a satisfaction of the loan and a release of the lien on the collateral. As for maintenance of flood insurance, it would seem reasonable to me that if the borrower doesn't maintain the insurance in force, the bank could force place and charge to the loan for later collection.

Answer by Dan Persfull:

If the property is titled to the borrower and you are collecting the charged off loan under a workout agreement, then I agree with Jim Bedsole.

If the property is now an OREO property, then it no longer meets the definition of a designated loan and the flood insurance would not be required; however, your S&S examiners might frown upon the bank for not having the property properly insured.

Land is Collateral not the House. Flood Insurance?

Question: I am currently processing a real estate loan in which the property is located in a flood hazard area. There is a house on the property but we will NOT be taking the house as collateral as the customer will be demolishing the house soon after the purchase. Since we are only using the land to secure the loan is the customer required to have flood insurance or is it considered a land only loan?

Answer by Dan Persfull:

Until the structure is demolished, it is an insurable structure. Therefore flood insurance will be required until it is demolished.

Your only exception would be if your mortgage specifically excludes the

structure. If you go this route I advise talking to your legal counsel to ensure you have the proper wording.

Adequacy of Flood Policy Limit

Question: One of our borrowers has flood insurance coverage of \$125,000. The outstanding principal balance is \$157,909 and the value of the property minus the land is \$159,000. The flood insurance policy had previously stated that it was 100% replacement cost (which was determined to be \$159,002). The policy for the current year does not state replacement cost anymore, so now I am wondering if the coverage is sufficient. Please let me know what you think.

Answer by David Dickinson:

This does not appear to be sufficient. Apparently, the property has appreciated in value. You need a minimum of \$157,909 (lesser of loan balance, appraised value or maximum available from the NFIP).