What is a “Buyout”? 

Since 1993, buyouts of flooded or damaged property have become increasingly common in the United States. A “buyout” is when a government entity purchases an at-risk property from a willing seller.

The purchase is made at a minimum of market value but often with a percentage increase above market value for additional costs incurred by the seller. Buyouts completed with federal money require that buildings are removed from the property and the property be permanently protected as open space.

Considering climate risks and increased flooding, what are the challenges and viability of buyouts, both in practice and from a policy perspective? Answering this requires some brief background on buyouts.

The National Flood Insurance Program (NFIP) is funded by a combination of the fees and premiums paid by insured properties. For much of the NFIP’s history since 1968, it has been self-supporting with this funding. However, when the NFIP lacks the funds to pay insurance claims, the federal taxpayer loans money to the NFIP to pay. In 2017, Congress cancelled $16 billion in debt. Despite this, as of 2022, the NFIP’s debt still exceeded $20 billion.

History of Buyouts

Understanding the development of buyouts requires basic knowledge of flooding and related policies in the United States. Flooding has consistently been the most expensive disaster hazard in the United States. At one time, homeowner insurance typically included flood losses. But the private insurance industry mostly stopped covering flood damage as part of homeowner insurance after the Great Mississippi Flood of 1927 bankrupted many insurance companies due to the scale of flooding losses.

As flooding losses continued to mount, the federal government was consistently saddled with the costs of major floods through federal aid to individuals, states, and local governments. At the same time, the development patterns that determined flood risk were determined by state and local governments without any direct federal control. As a result, the risks and costs of local government decisions fell on the federal government.

Figure 1: Flooded streets in the Fort Lauderdale neighborhood after Hurricane Sandy

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NFIP Glossary of Terms

**Flood Insurance Rate Map (FIRM):**

Official map of a community on which FEMA has delineated the Special Flood Hazard Areas (SFHAs), the Base Flood Elevations (BFEs) and the risk premium zones applicable to the community.

**Repetitive Loss Structure:**

An NFIP-insured structure that has had at least 2 paid flood losses of more than $1,000 each in any 10-year period since 1978.

**Severe Repetitive Loss Building:**

Any building that (1) is covered under a Standard Flood Insurance Policy made available under this title; and (2) has incurred flood damage for which:

- four or more separate claim payments have been made under a Standard Flood Insurance Policy issued pursuant to this title, with the amount of each such claim exceeding $5,000, and with the cumulative amount of such claims payments exceeding $20,000; or

- at least two separate claims payments have been made under a Standard Flood Insurance Policy, with the cumulative amount of such claim payments exceeding the fair market value of the insured building on the day before each loss.

The National Flood Insurance Program (NFIP), currently part of the Federal Emergency Management Agency (FEMA), emerged in 1968 to address the billions of dollars spent by the federal government in flood relief driven by local development decisions.³ The NFIP sought to use federal authority to drive better floodplain management at the local level by offering flood insurance to property owners if their local government established flood management policies meeting federally established minimums.⁴

**Financial Challenges for the NFIP**

The incentive of making flood insurance available to residents would encourage local governments to adopt the minimum federal standards for floodplain management to reduce flood risk for new construction. Residents want their local government to participate since properties in certain mapped flood zones can only secure government-backed mortgages if they have flood insurance. Considering 95% of residential mortgages in the United States are backed by the federal government, the availability of flood insurance is crucial for many property owners. Another incentive for property owners to purchase flood insurance is subsidized policies for properties that existed prior to the NFIP, even if the existing structures did not meet minimum standards, such as elevation requirements.


The NFIP’s structure and mission, however, contain an inherent contradiction. Congress wanted the program to set insurance rates so that the income from the program mostly covered the program’s costs. At the same time, Congress mandated subsidies to properties built before the NFIP and did not allow for large capital reserves in the NFIP to cover catastrophic losses, for which Congress authorized—and has consistently had to increase—borrowing of money from the U.S. Treasury. As of 2022 the NFIP is about $20 billion in debt despite forgiveness by the U.S. Treasury of $16 billion of NFIP debt in 2017.

The Great Flood of 1993 is considered the most costly and devastating flood to hit the United States since the Great Flood of 1927. Both floods impacted the Mississippi River, but the 1993 flood began further north and included flooding on the Missouri River. The Mississippi River crested at 49.6 feet in St. Louis, almost 20 feet above flood stage. The Great Flood of 1993 covered nine states and 400,000 square miles with flooding that lasted almost 200 days in some places. The flood caused 50 deaths and damages of nearly $15 billion.

In 2020, more than 22,487 local jurisdictions across the country participated in the NFIP\(^5\) with about 51 million policies and about $1.3 trillion of coverage.\(^6\) NFIP insurance policies are only available to residents whose local governments have applied to the NFIP and meet minimum standards for floodplain management and development. NFIP-insured structures that qualify as “repetitive loss” structures, even though they make up less than 3% of insured properties,\(^7\) accounted for 32% of NFIP’s claims paid out from 2017 to 2019.\(^8\) As of 2015, just 0.6% of NFIP-insured structures that qualified as “severe repetitive loss” accounted for almost 10% of all damages paid by the NFIP through 2015.\(^9\)

As part of the strategy to address “repetitive loss” and “severe repetitive loss” structures, FEMA and the NFIP concluded that it would be less expensive for the heavily indebted NFIP to purchase the properties with such structures rather than continue to make payout after payout for repairing them only to see them flooded again. Anecdotal stories reinforced the idea that purchasing some properties was much more economically efficient. Many researchers supported this analysis of buyouts as a more economically efficient\(^10\) policy than continual payouts\(^11\). Between 1989 and 2018, FEMA assisted in buyouts of about 40,000 properties around the country.\(^12\)

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\(^6\) Dena Adler & Joel Scata, BREAKING THE CYCLE OF “FLOOD-REBUILD-REPEAT”: Local and State Options to Improve Substantial Damage and Improvement Standards in the National Flood Insurance Program 2 (January 2019), at https://academiccommons.columbia.edu/doi/10.7916/d8-n91e-94rc—text=Duel%20large%20recent%20flood%20disasters%2C%20the%20NFIP%20to%20%20rising%20debt%20%20the%20NFIP%20program

\(^7\) Compare, e.g., U.S. Government Accountability Office, report GAO-20-508, National Flood Insurance Program: Fiscal Exposure Persists Despite Acquisitions 25, figure 6 (June 2020) with total number of policies for 2020 to arrive at this approximate figure.


\(^9\) Dena Adler & Joel Scata, BREAKING THE CYCLE OF “FLOOD-REBUILD-REPEAT”: Local and State Options to Improve Substantial Damage and Improvement Standards in the National Flood Insurance Program 1 (January 2019), at https://academiccommons.columbia.edu/doi/10.7916/d8-n91e-l94c—text=Duel%20large%20recent%20flood%20disasters%2C%20the%20NFIP%20to%20%20rising%20debt%20%20the%20NFIP%20program


The cost amounted to a little over $4 billion.\textsuperscript{13} However, buyouts really did not become a major part of hazard mitigation until the Great Flood of 1993.\textsuperscript{14}

A related rationale for buyouts of repetitively flooded or at-risk properties is that a buyout is a way to permanently end the risk of flooding to a property since FEMA-funded buyouts require that structures be demolished or moved out of the floodplain and the land be conserved as open space. With such strong reasons for buyouts, readers may wonder what the progress of buyouts has been in promoting the fiscal stability of the NFIP and permanently decreasing risk of individual parcels and reducing risk to flooding overall?

Financial and Risk-Management Results of Buyouts

Despite spending billions of dollars to purchase at-risk properties, the federal government in 2020 concluded that the number of repetitive loss properties has continued to increase.\textsuperscript{15} In fact, from 2009 to 2018, the total number of “nonmitigated”\textsuperscript{16} repetitive loss properties grew by more than twice as much as the number of properties mitigated.\textsuperscript{17} In addition, from 2009 to 2017, over half of US coastal states built more homes in coastal areas at high risk of chronic inundation driven by sea level rise than in safer areas.\textsuperscript{18}

Even with dramatic increases in money dedicated to buyouts and much faster processes to conduct them, buyouts will not address the long-term efforts to reduce potential flood losses that will increase due to the combination of more development, climate change, and rising seas.

An additional challenge is that a massive scaling up of buyouts as a “solution” to flooding problems increases the risk of “moral hazard.” Moral hazard “arises when persons have an incentive to engage in excessive risk-taking because someone else (the insurer) bears the risk.”\textsuperscript{19} The more property owners assume that the federal government either will or must “buy them out,” the less likely property owners are to do everything possible to avoid the risk of flooding, including purchasing or building in safer areas. This dynamic could particularly extend to artificially inflating property values in coastal areas: even if we know that rising seas will cause more and more coastal flooding in an area, the idea that the government has to buyout property owners could keep property values higher than the increasing risk of future loss might otherwise indicate in a freer market. In addition to promoting more flood losses directly, such a dynamic would also increase the buyout costs due to higher values for at-risk properties.

\begin{itemize}
  \item \textsuperscript{16}“Mitigation” of repetitive loss properties may occur by acquisition, elevation, or a combination of these to reduce exposure to flood risk and may occur by virtue of programs other than FEMA-sponsored buyouts. In fact, most mitigation of properties is not a product of FEMA action. U.S. Government Accountability Office, report GAO-20-508, National Flood Insurance Program: Fiscal Exposure Persists Despite Acquisitions 25, figure 6 (June 2020).
  \item \textsuperscript{18}Climate Central & Zillow, Ocean at the Door: New Homes and the Rising Sea 2 (November 2018).
\end{itemize}
Buyout policy also exhibits difficulties on the practical implementation side. Buyouts often occur in the aftermath of a declared disaster. Many recipients and researchers have noted that the complexity of buyouts favors communities that have the financial and administrative means to apply for, receive, and administer the federal funds supporting FEMA-funded buyouts. These communities tend to be whiter, wealthier communities; these communities then tend to focus buyouts on properties owned by minorities due to their lower property values rather than buying out white property owners, leading to challenging questions about fairness and community impacts of buyouts.

The administrative complexity of buyouts leads to another frequently noted concern with buyouts: they are slow. A buyout often takes years to complete, even though the property at issue may be unlivable or severely damaged. The owners or residents of the property are either living in a damaged property or need other housing during this time. Or, alternatively, the owner may make repairs to the property while waiting for a possible buyout, and thus decide not to participate in the buyout program at all. The long list of practical challenges of buyouts for property owners has resulted in efforts to gather information and data to formulate policy suggestions to make the process less complex and quicker.

Finally, buyouts may also create issues for the local governments that are supposed to facilitate them. For example, since FEMA buyouts require voluntary property sellers, it may be that only one or a few properties eligible for buyouts choose to participate, meaning that a patchwork of inhabited properties remains. This creates a problem for the affected local government: even as the local government loses property tax revenue from the properties bought out, the per-parcel costs of continuing to provide infrastructure and other services to the remaining properties increase.

Figure 3: Properties on the Peace River in Charlotte County face a long road to recovery after Hurricane Ian flooding and damage. Photo credit: Kate Rose

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Conclusion

In summary, buyouts can permanently eliminate flood risk on a property and decrease financial liabilities to which taxpayers are exposed. However, as currently implemented, buyouts present significant difficulties for property owners and may run counter to some competing local government priorities. Buyouts may also create problematic policy dynamics, such as artificially inflating the value of at-risk properties and creating unrealistic expectations on the part of property owners that the government “must” buyout their properties.

While buyouts of properties that have flooded or are at risk of flooding will likely remain part of NFIP and FEMA hazard-reduction policies, buyouts cannot realistically be expected to single-handedly achieve the hazard-mitigation goals of the NFIP, FEMA, and our country. The overall cost of buying out all at-risk properties and the construction of new homes in current or future at-risk areas mean that buyouts will very likely not be able to keep pace with increasing flooding risk, especially as sea level rise continues to accelerate and create new flood risk for existing properties.

For more information and legal resources related to this topic, contact Thomas Ruppert, Esq., Coastal Planning Specialist, Florida Sea Grant College Program (truppert@ufl.edu).