The Watermark

FEDERAL INSURANCE & MITIGATION ADMINISTRATION

Fiscal Year 2018, Second Quarter
Volume 2

A Message from the Deputy Associate Administrator for Insurance and Mitigation:

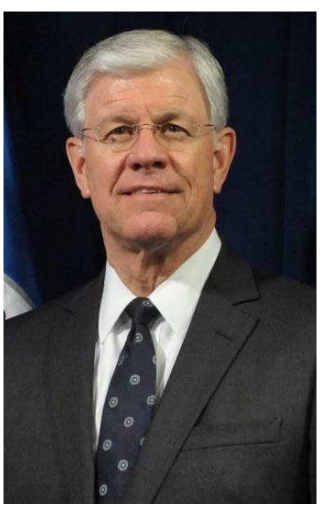
It is with mixed emotions that I bid farewell to our former Deputy Associate Administrator for Insurance and Mitigation, Roy Wright, who is now the new President and Chief Executive Officer of the Insurance Institute for Business & Home Safety in in Charlotte, North Carolina. His work and dedication to FEMA over the past five years have helped shape the National Flood Insurance Program (NFIP). Though the NFIP cannot achieve a sound financial framework as currently designed, his efforts moved us closer to that goal. I am honored to continue these efforts.

The second quarter of fiscal year 2018 was an active one for the NFIP and its policyholders. Though winding down from the first quarter, the NFIP continues to pay claims resulting from hurricanes Harvey, Irma and Maria. Through partnerships with approximately 67 Write-Your-Own companies, FEMA's Federal Insurance and Mitigation Administration (FIMA) remained dedicated to servicing the claims and expediting the recovery for insured survivors, as well as enrolling new policy holders impacted by the hurricanes.

Building upon the success of the first reinsurance placement, on January 1st, FIMA secured a second reinsurance contract for 2018 covering $1.5 billion of total exposure. Though no silver bullet, FIMA's transfer of risk to the private capital markets through reinsurance bolsters the program's financial position, as you will see on the back page. Moving forward, FIMA is looking to continue engaging the private market for risk transfer, including through the issuance of Insurance-Linked Securities/Catastrophe (ILS/CAT) bonds.

The greatest challenge the NFIP's finances continues to face is its $20.525 billion of debt. On March 31st, the NFIP paid $170 million dollars to service the debt, and is estimated to pay over $375 million in interest payments this fiscal year. Since Hurricane Katrina, the NFIP has paid over $4 billion solely for interest expenses to the Treasury - more than enough for the recovery of over 43,000 survivors from 2016's Hurricane Matthew and Louisiana Flooding combined. The interest expenses account for roughly ten percent of NFIP premium revenue, and continues to cripple the long-term soundness of the Program. More information on the NFIP's past and future projected interest expenses is available on the back page.

FIMA's chief priority continues to be providing the NFIP's policy holders with excellent service. One of the current initiatives towards this end is the Affordability Study, which will be featured in the next edition of the Watermark. Ahead of the hurricane season we hope all partners help advocate and encourage homeowners and renters to buy flood insurance.



Sincerely,

David I. Maurstad
Deputy Associate Administrator for Insurance and Mitigation

$1.278 trillion
Insurance in Force

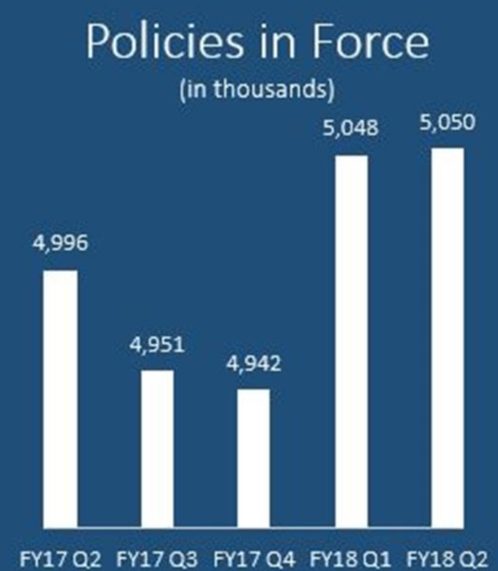
Over $40 billion
Probable Maximum Annual Loss (PML)

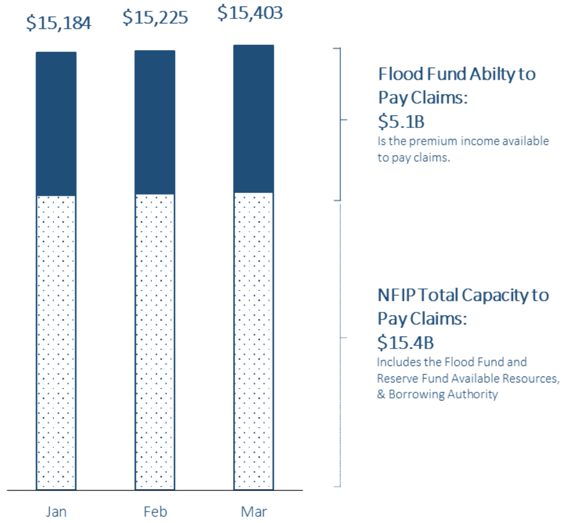
20,315
Participating Communities

$703
Average Annual Premium

$20.525 billion
Outstanding Debt with Treasury

$4.003 billion
Interest Paid Since Hurricane Katrina





NFIP AVAILABLE RESOURCES

Available Resources is representative of a private-sector "Balance Sheet," or a snapshot of the NFIP's finances, including any prior period carryover.

NFIP Resources *($ in Thousands)*	Dec 31, 2017	Mar 31, 2018
Flood Fund Balance	6,997,737	5,785,561
Outstanding Obligations	(1,715,845)	(728,090)
Flood Fund Available Resources	5,281,892	5,057,471
Reserve Fund Balance	503,662	445,658
Net Investments	0	0
Outstanding Obligations	0	0
Reserve Fund Available Resources	503,662	445,658
Remaining Borrowing Authority	9,900,000	9,900,000
NFIP Total Capacity to Pay Claims*	15,685,554	15,403,129

*FEMA's CY18 traditional reinsurance placement augments the NFIP's Capacity to Pay Claims. After losses for a single event exceed $4B until $8B the NFIP may collect up to $1.46B, meaning the Capacity to Pay Claims would be $16.863B. FEMA paid $235M for the coverage.

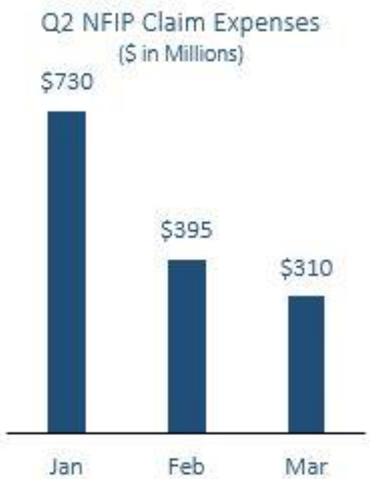
STATEMENT OF OPERATIONS

($ in Thousands)

REVENUE - NATIONAL FLOOD INSURANCE FUND	FY 2017	FY 2018 Q2	FY 2018 YTD
Premium	3,012,988	669,103	1,549,489
Reinsurance Collections	0	0	1,042,000
Federal Policy Fee	194,652	38,651	78,972
Other Revenue	13,938	2,608	7,966
Total Flood Fund Revenue	3,221,578	710,362	2,678,427
EXPENSES – NATIONAL FLOOD INSURANCE FUND	**FY 2017**	**FY 2018 Q2**	**FY 2018 YTD**
Loss & Loss Adjustment (Claims)	3,315,844	1,435,313	8,640,020
Commissions	62,055	13,165	28,581
WriteYourOwn (WYO) Expense Allowance	920,488	272,149	473,598
Interest Paid on Debt	393,761	169,923	173,048
Floodplain Management & Mapping Activities	150,847	37,792	54,309
Flood Related Grant Activities	208,585	5,322	6,610
Other Expenses	195,536	88,830	133,307
Total Expenses	5,247,116	2,022,495	9,509,473
FLOOD FUND NET INCOME (LOSS)	(2,025,538)	(1,312,133)	(6,831,046)

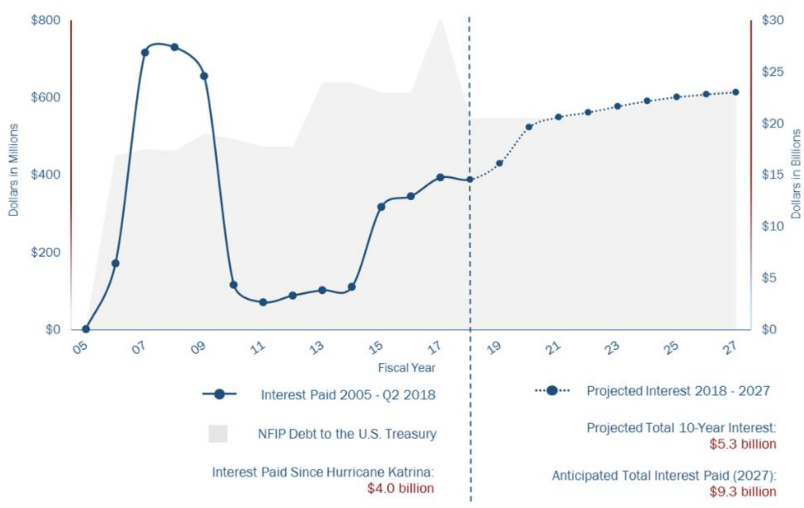
The NFIP's Statement of Operations is representative of an "Income Statement" usually seen in private-sector organizations. The current report is for the period ending FY 18 Quarter 2 or March 31st, 2018.

REVENUE - NATIONAL FLOOD INSURANCE RESERVE FUND	FY 2017	FY 2018 Q2	FY 2018 YTD
Assessment	484,182	97,371	233,886
Surcharge	395,517	79,254	192,175
Premium Redemption & Interest	132,781	0	0
Total RF Revenue	1,012,480	176,625	426,062
EXPENSES – NATIONAL FLOOD INSURANCE RESERVE FUND	**FY 2017**	**FY 2018 Q2**	**FY 2018 YTD**
Loss & Loss Adjustment (Claims)	1,502,359	0	495,979
Reinsurance	150,048	234,629	234,629
Total RF Expenses	1,652,407	234,629	730,608
RESERVE FUND NET INCOME (LOSS)	(639,927)	(58,004)	(304,546)



Interest Expense

On March 31, 2018 the NFIP made a semi-annual interest payment of $170 million to the U.S. Treasury. With this payment, the NFIP has now paid over $4 billion in interest since Hurricane Katrina. The NFIP is projected to pay an additional $5.3 billion of interest over the next 10 years, for a total of $9.3 billion by 2027. To put this figure in perspective, interest expenses paid could more than cover the 130,000 claims paid to survivors of Hurricane Sandy.



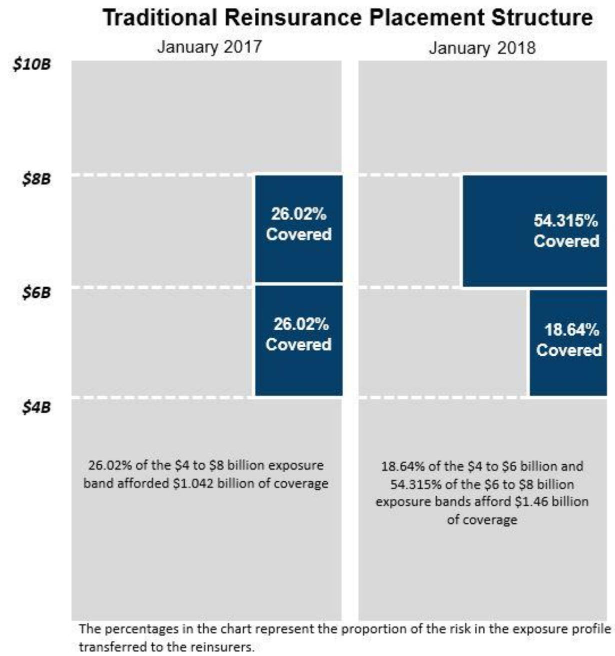
The NFIP's interest expense is a function of debt principal and the prevailing interest rates. Prior to Hurricane Katrina's landfall in 2005, the NFIP paid back all debt along with corresponding interest. However, catastrophic losses in 2005 led to more than $16 billion in debt that the NFIP is not structured to pay off. Given the high interest rates at the time, the NFIP paid close to $700 million in annual interest for three years. After the financial crisis in 2008, the interest rates dropped and the NFIP paid less in interest, despite growing debt resulting from Hurricane Sandy and later storms.

Following the historic 2017 hurricane season - which saw the NFIP exhaust its borrowing authority with the U.S. Treasury before receiving $16 billion of debt cancellation - the Program now carries $20.525 billion dollars of debt and pays over $1 million in interest daily. As interest rates are anticipated to rise, the interest associated with carrying this debt are projected to grow as well. FIMA has mitigated against some of the risk of rising interest rates by locking in more than half of its debt portfolio in long term notes.

The NFIP, as currently structured, is not built to handle this level of debt and the corresponding interest payments. No matter FIMA's debt strategy or the prevailing rates, it will not be able to pay down the debt and interest will continue to consume revenue that would otherwise serve to grow the NFIP's ability to pay claims to insured survivors.

Reinsurance

Reinsurance is insurance for insurance companies, and is a financial mechanism that insurance companies use to protect against large financial losses. Under traditional reinsurance, insurers transfer a portion of their risk to the reinsurance markets for a premium. In exchange, reinsurers provide coverage for losses incurred by insurance providers up to a specified amount negotiated by both parties.



Historically, the NFIP has relied on flood insurance premiums, borrowing capacity from the U.S. Treasury, and in some cases direct Congressional appropriations to pay the claims of insured survivors. Through the Biggert-Waters Flood Insurance Reform Act of 2012 and the Homeowner Flood Insurance Affordability Act of 2014, Congress authorized FEMA to secure reinsurance from the private reinsurance and capital markets.

The NFIP made its first "cornerstone" traditional reinsurance placement in 2017, and transferred $1.042 billion in risk exposure to 25 reinsurance companies. Following losses associated with Hurricane Harvey, FEMA recovered the $1.042 billion from the reinsurance companies under the agreement. In early January 2018, FEMA made a second cornerstone placement by paying $235 million in premium to secure $1.46 billion in reinsurance from 28 reinsurance companies to cover any qualifying flood losses in excess of $4 billion per event occurring in calendar year 2018.

Reinsurance extends and enhances the NFIP's capacity to pay flood claims after catastrophic flood events, reducing reliance on the U.S. Treasury. As a result, the NFIP is now in a better financial position to manage catastrophic events like Hurricane Harvey. However, while FIMA uses reinsurance as an additional risk management tool to strengthen the financial framework of the NFIP, it is by no means a panacea - the program still carries a non-repayable level of debt and has billions of dollars of unmanaged exposure.