

Frequently Asked Question and Answer

August 21, 2015

Question

Under what circumstances may a lender exempt a detached structure from mandatory flood insurance purchase requirements?

Short Answer

An exemption from mandatory flood insurance purchase requirements is available for certain detached structures located on residential property. In the event that certain criteria are met; lenders may, but are not required to, exclude these structures from the mandatory purchase requirements. In considering whether to require flood insurance on detached structures, lenders are ultimately responsible for making a good faith determination as to whether the structure meets the criteria for exclusion.

Detailed Answer

The 2014 Homeowner Flood Insurance Affordability Act amended the Flood Disaster Protection Act to exempt from the mandatory flood insurance purchase requirements certain detached structures. On June 22, 2015, regulatory authorities promulgated a joint final rule, implementing certain provisions of both the 2012 Biggert-Waters Act as well as the 2014 Homeowner Flood Insurance Affordability Act, including the exemption for detached structures. In order to qualify for the exemption, the structure must meet three conditions. The structure must be part of the residential property, detached from the primary residential structure and must not serve as a residence.

The final rule defines a structure that is part of residential property to be a structure used primarily for personal, family or household purposes; and not used for agricultural, commercial, industrial purposes. It is important to note that it is the use of the property that governs whether this standard is met, and not the purpose of the loan. As such, it is possible for a structure located on real property securing a commercial purpose loan to meet the standard, as long as the property itself is not primarily used for business, agricultural or industrial purposes.

The second criteria is that the structure must be detached from the primary residential structure. The final rule provides a clear definition of the term “detached”: In order for a structure to be considered detached, it must not be joined to the primary structure by any structural connection. As such, it must be a stand-alone structure.

The final condition is that the structure must not serve as a residence. The final rule does not prescribe a fixed set of criteria to determine whether a structure may serve as a residence; rather lenders are charged with making a bona fide determination concerning the intended use of the structure. The final rule states that a property serves as a residence if the lender makes a determination that the structure is intended for use or actually used as a residence, which generally includes sleeping, bathroom and kitchen facilities. Lenders must consider the intended use of the structure as well as the actual use. The fact that a structure intended for use as a residence is currently vacant does not alter its classification. The structure’s intended use precludes it from meeting the requirement necessary for exemption from flood insurance purchase requirements.

Additionally, while the final rule states that properties intended for use as residences generally include sleeping, bathroom and kitchen facilities; there is not language in the rule to indicate that structures lacking these facilities could not be considered to be intended for residential use. For example, a detached guest house may share bathroom facilities with the main house; nevertheless, the guest house still serves as a residence for purposes of flood insurance requirements.

Ultimately, lenders are responsible for making a good faith determination on whether detached structures meet the requirements for exemption from mandatory flood insurance purchase requirements whenever making, increasing, renewing or extending a loan. Loan files should contain sufficient documentation to demonstrate the rationale for the lender's decision with respect to detached structures. Finally, it should be noted that while lenders are free to exempt detached structures that meet the above criteria from the mandatory flood insurance purchase requirements, they are not required to do so. Lenders retain discretion to require flood insurance on these structures for safety and soundness purposes.

For additional information on this topic, please contact Brian Shea at bshea@wolfandco.com or Erica Torres at etorres@wolfandco.com.