

# GUIDANCE IN DETERMINING SUBSTANTIAL IMPROVEMENTS

## Overview

The National Flood Insurance Program (NFIP) is a federal program that allows property owners to purchase flood insurance. The Federal Emergency Management Agency (FEMA) administers the NFIP.

The NFIP is based on the agreement that if a community will implement floodplain management measures to reduce future flood risks to new construction and substantially improved structures in flood hazard areas, then the federal government will make flood insurance available within the community as a financial protection against flood losses that do occur.

## Intended use and users of this document

The purpose of this document is to provide guidance to local municipalities in addressing flood plain development issues, specifically emphasizing “substantial improvements” and the role of the appraisal. The intended users of this document include the community administrators and enforcement officers responsible for local compliance with the NFIP requirements. This document may also be helpful to property owners considering the rehabilitation of, or addition to, a structure located within a flood hazard area. Real estate appraisers

should also consult this document when preparing the appraisal of a structure(s) with NFIP implications.

### **Summary of substantial improvement regulations**

Substantially improved structures must be brought into compliance with NFIP regulations and other requirements of the local ordinance, which are applicable to new construction. Therefore, a substantially improved structure must be elevated (or flood proofed if it is a non-residential structure) to, or above the level of the 100-year or base flood. A substantially improved structure must also meet any other applicable local requirements.

A substantial improvement is defined in 44 Code of Federal Regulations 59.1 as follows: *"any reconstruction, rehabilitation, addition or other improvement of a structure, the cost of which equals or exceeds 50 percent of the market value of the structure before the "start of construction" of the improvement. This term includes structures which have incurred 'substantial damage', regardless of the value of or actual cost of repair work performed. The term does not, however, include either (1) any project for improvement of a structure to correct existing violations of state or local health, sanitary or safety code specifications which have been identified by the local code enforcement official and which are the minimum necessary to assure safe living conditions or (2) any alteration of a 'historic structure', provided that the alteration will not preclude the structure's continued designation as a 'historic structure'."*

## **Community participation in NFIP**

In accordance with the National Flood Insurance Act of 1968, FEMA may not provide flood insurance to a property owner unless its surrounding community adopts and enforces floodplain management criteria, which meet or exceed the federal minimum. The NFIP defines a community as: *“any State, or area or political subdivision thereof, or any Indian tribe or authorized tribal organization, or Alaska Native village or authorized native organization, which has authority to adopt and enforce floodplain management regulations for the areas within its jurisdiction.”*

FEMA has no direct participation in the administration of local floodplain management since the federal government does not have local land use authority. Since its inception, however, the NFIP has prompted the creation of thousands of voluntary community floodplain management programs throughout the country. Overall, the program is credited with large reductions in potential average annual flood damages for new construction. There is still, however, significant flood damage potential for existing flood-prone buildings since millions of pre-existing structures are located in flood hazard areas.

## **Minimum floodplain management criteria**

The minimum floodplain management criteria are detailed in the Code of Federal Regulations at 44CFR60.3. The regulations for substantially improved buildings, in general, require that in A Zones, the lowest floor (including

basement) must be elevated to or above the Base Flood Elevation (BFE). Nonresidential structures in A Zones can be either elevated or dry-flood proofed. Buildings in V Zones must be elevated on piles and columns and the bottom of the lowest horizontal structural member of the lowest floor must be elevated to or above the BFE.

### **Substantial improvements**

A substantial improvement is determined as the ratio of the cost of enhancements to the building structure compared to the market value of the building structure prior to the start of construction of enhancements. For example, if the market value of a house is \$100,000 prior to a renovation, which costs \$50,000, then this enhancement represents a substantial improvement ( $\$50,000/\$100,000 = 50\%$ ) and is subject to NFIP regulations. The responsibility for reasonable estimates of enhancement costs and market value ultimately rests with the community permit officials.

### **Estimating the cost of enhancements**

Licensed contractors or professional estimators are well positioned to provide estimates of cost of enhancements. Building cost information services such as Marshall Valuation Service publish various tools that can help community officials evaluate the overall reasonableness of cost estimates. These estimates

should be itemized for materials and labor and provided to the local building permit department for review. Labor cost estimates should reflect applicable wage scales for the type of construction work to be performed regardless of whether the labor is to be paid, provided by the owner or volunteered.

The cost of building plans, specifications, surveys, permits and other items incidental to the actual enhancement construction costs should be excluded. The cost of repairs necessary to correct health, sanitation or safety code violations can also be deducted from the enhancement cost estimates. An appropriate regulatory official, however, must be informed of and confirm the extent of the code deficiencies. Furthermore, the deficiencies must exist prior to the building enhancements and not be triggered solely by the enhancements. Only the cost of minimum necessary repairs required to assure safe living conditions may be deducted to correct health, sanitation or safety code deficiencies.

### **Estimating market value**

When the enhancement is believed to be obviously less than or greater than 50%, certain screening tools may be sufficient to estimate the market value of the structure. These methods include tax assessments, "Actual Cash Value" and qualified estimates based on sound professional judgment by the staff of the community's building or tax assessor's office. When tax assessments are considered, they should include the full assessment for the structure only and be

adjusted to reflect current market conditions. The structure's "Actual Cash Value" reflects the estimated replacement cost for the building only, less all depreciation (see Answers to Questions About Substantially Damaged Buildings, Answer 23, FEMA, March, 1991).

### **The appraisal**

As the ratio of enhancement cost to market value approaches 50%, the estimates of cost and market value require greater precision. An appropriately state certified or licensed real property appraiser can best estimate the market value of the building structure prior to enhancements. An appraisal for this purpose should reflect the estimated market value of the structure only, exclusive of any value attributable to the land, landscaping or other site improvements. The appraisal should indicate the market value of the structure, as it exists prior to construction of the enhancements and reflecting its current level of depreciation.

The appraiser should apply the approach or approaches necessary to reach supportable conclusions. Each valuation method should either exclude or deduct the contributory value of the land, landscaping and other site improvements.

In the sales comparison approach, for example, an appraiser may use a number of house transactions as comparable sales. These transactions likely include the building improvements, as well as the underlying land, landscaping and site

improvements. Therefore, a supportable estimate of the contributory land value, landscaping and site improvements would be deducted to reach a value indication for the structure only.

In the cost approach, the value indication should again exclude the land value. All depreciation must be deducted from the estimated cost new of the structure. It would be inappropriate to indicate the market value of a structure as simply the cost new of the structure without considering an appropriate adjustment for depreciation.

If the income capitalization approach is applied, it too should reflect the value of the structure exclusive of land, landscaping and site improvements. Furthermore, the value indicated by this, or any of the approaches, should reflect real property value only and should not include personal or intangible property, business value, inventory or equipment.

The appraisal must comply with the Uniform Standards of Professional Appraisal Practice. Most states, including Delaware, require appraisers to be duly certified or licensed. The Delaware Council on Real Estate Appraisers regulates the certification and licensure of real estate appraisers, and has the authority to impose disciplinary sanctions against licensees. Complaints against

appraisers may be submitted to the Division of Professional Regulation, 861 Silver Lake Blvd., Suite 203, Dover, DE 19904-2467.

### **Consequences of community non-compliance**

**Probation** - Per 44 CFR 59.24 (b) A community eligible for the sale of flood insurance which fails to adequately enforce flood plain management regulations meeting the minimum requirements set forth in §§ 60.3, 60.4 and/or 60.5 shall be subject to probation. Probation shall represent formal notification to the community that the administrator regards the community's flood plain management program as not compliant with NFIP criteria. Prior to imposing probation, the Administrator (1) shall inform the community upon 90 days prior written notice of the impending probation and of the specific program deficiencies and violations relative to the failure to enforce, (2) shall, at least 60 days before probation is to begin, issue a press release to local media explaining the reasons for and the effects of probation, and (3) shall, at least 90 days before probation is to begin, advise all policyholders in the community of the impending probation and the additional premium that will be charged, as provided in this paragraph, on policies sold or renewed during the period of probation. During this 90-day period the community shall have the opportunity to avoid probation by demonstrating compliance with Program requirements, or

by correcting Program deficiencies and remedying all violations to the maximum extent possible. If, at the end of the 90-day period, the Administrator determines that the community has failed to do so, the probation shall go into effect. Probation may be continued for up to one year after the community corrects all Program deficiencies and remedies all violations to the maximum extent possible.

When attempts to resolve enforcement problems through community assistance or consultation have failed, the FEMA Regional Director may place a community on probation. The probationary period lasts at least until all program deficiencies have been corrected and violations have been remedied to the maximum extent possible, and it may be extended for up to one year after that. Probation has no effect on the continued availability of flood insurance; however, an additional charge of \$50.00 will be added to the premium for each policy for a period of at least one year.

**Suspension** – Per 44 CFR 59.24 (c) If the community fails to take remedial measures during the probationary period, the Regional Director may recommend suspension from the NFIP.

New flood insurance coverage cannot be purchased and policies cannot be renewed in a suspended community. In addition, three-year policies become void at the end of the current policy year with a pro rata refund given for any remaining years of the original three-year policy term.

A community eligible for the sale of flood insurance which fails to adequately enforce its flood plain management regulations meeting the minimum requirements set forth in §§ 60.3, 60.4 and/or 60.5 and does not correct its Program deficiencies and remedy all violations to the maximum extent possible in accordance with compliance deadlines established during a period of probation shall be subject to suspension of its Program eligibility. Under such circumstances, the Administrator shall grant the community 30 days in which to show cause why it should not be suspended. The Administrator may conduct a hearing, written or oral, before commencing suspensive action. If a community is to be suspended, the Administrator shall inform it upon 30 days prior written notice and upon publication in the FEDERAL REGISTER under part 64 of this subchapter of its loss of eligibility for the sale of flood insurance. In the event of impending suspension, the Administrator shall issue a press release to the local media explaining the reasons and effects of the suspension. The community's eligibility shall only be reinstated by the Administrator upon his receipt of a local legislative or executive measure reaffirming the community's formal intent to

adequately enforce the flood plain management requirements of this subpart, together with evidence of action taken by the community to correct Program deficiencies and remedy to the maximum extent possible those violations which caused the suspension.

### **Web links**

Appraisal Institute	<a href="http://www.appraisalinstitute.org/">http://www.appraisalinstitute.org/</a>
Appraisal Foundation	<a href="http://www.appraisalfoundation.org/">http://www.appraisalfoundation.org/</a>
Delaware Council on Real Estate Appraisers	<a href="http://www.dpr.delaware.gov/boards/realestateappraisers/">http://www.dpr.delaware.gov/boards/realestateappraisers/</a>
Delaware Division of Professional Regulations	<a href="http://www.dpr.delaware.gov/">http://www.dpr.delaware.gov/</a>
Federal Emergency Management Agency	<a href="http://www.fema.gov/">http://www.fema.gov/</a>
Marshall Valuation Service	<a href="http://www.marshallswift.com/">http://www.marshallswift.com/</a>