

Will New York's New Flood Insurance Law Create a Coinsurance Problem for Lenders and Policyholders?

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A law recently passed by the New York State Assembly and signed by Gov. Kathy Hochul puts significant limits on the flood insurance that lenders can require borrowers to purchase on loans secured by residential real property. Commentary in the weeks since the law went into effect has focused on potential conflicts between the law and the federal Flood Disaster Protection Act or the potential for loans and properties to be underinsured for flood. Another hidden problem may occur, however, if policyholders opt to purchase coverage for significantly less than the building replacement cost on a policy that includes a coinsurance penalty.

Signed by Gov. Hochul on December 13, 2024, and effective immediately, [Assembly Bill A5073A](#) prohibits mortgage lenders from requiring borrowers to obtain flood insurance on improved residential real property at a coverage amount exceeding the outstanding principal mortgage balance as of the beginning of the year for which the policy shall be in effect, or that includes contents coverage. The bill additionally requires lenders to provide clear and conspicuous notice to borrowers that the required flood insurance will only protect the lender's interest and may not be sufficient to pay for repairs or other loss after a flood.

Of course, purchasing coverage for less than full replacement cost of the insured building carries the risk that coverage will be insufficient to rebuild or repair in the event of a loss. But policyholders who consider taking this chance should also consider whether their flood policy has a coinsurance penalty. These provisions can limit payouts to insureds who purchase coverage for substantially less than the building replacement cost by paying only a fraction of the full loss. For example, both the FEMA and ISO personal flood policies have the potential to pay only a specified portion of the loss or the actual (depreciated) cash value, whichever is greater, when insurance limits are less than 80% of full replacement cost. Even if the policy pays the actual cash value, however, the policyholder and their lender may come in for a nasty shock if the depreciated cash value of the building is many thousands of dollars less than what is needed to complete repairs.

If a coinsurance penalty applies, purchasing coverage at the amount of the outstanding mortgage principal balance under New York's law thus does not necessarily translate into an insurance payout in that amount. Notably, the notice required to be given to mortgagors by New York does not include a specific warning to the property owner of this possibility.

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