

# PUBLICATION

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## When the Minimum is Not Enough: Eleventh Circuit Rules that Lenders May Require Borrowers to Obtain More than the Minimum Flood Insurance

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The United States Court of Appeals for the Eleventh Circuit recently resolved a district court split regarding minimum flood insurance coverage by holding that a lender may require a borrower who has a federally-insured mortgage to obtain flood insurance beyond the amount mandated by federal law. *Feaz v. Wells Fargo Bank, N.A., et al.*, 745 F.3d 1098 (11th Cir. 2014).

The Eleventh Circuit stated that while some courts have found that the Department of Housing and Urban Development (HUD) regulation regarding insurance against floods was ambiguous and therefore did not unequivocally indicate whether the required amount was merely a minimum or a set maximum, it agreed with the other courts that have interpreted that set amount as a minimum, thereby allowing lenders to require more insurance to cover the replacement value of the insured property.

In *Feaz*, the borrower obtained a \$61,928 mortgage loan that was guaranteed by the Federal Housing Administration (FHA). When the FHA guarantees a mortgage loan for a home located in an area designated by the Federal Emergency Management Agency (FEMA) as presenting "special flood hazards" (as was the case in *Feaz*), HUD requires that the home be covered by flood insurance "in an amount equal to either the outstanding balance of the mortgage, less estimated land cost, or the maximum amount of the [National Flood Insurance Program] insurance available with respect to the property improvements [*i.e.*, \$250,000], whichever is less." Accordingly, *Feaz's* mortgage contract contained the following covenant (which is required by federal law for all FHA-insured mortgage contracts):

**Fire, Flood and Other Hazard Insurance.** Borrower shall insure all improvements on the Property, whether now in existence or subsequently erected, against any hazards, casualties, and contingencies, including fire, for which Lender requires insurance. This insurance shall be maintained in the amounts and for the periods that Lender requires. Borrower shall also insure all improvements on the Property, whether now in existence or subsequently erected, against loss by floods to the extent required by the Secretary [of HUD].

Ms. *Feaz* obtained \$63,000 in flood insurance when she obtained the loan from her initial lender, which was more than the loan's principal balance but less than the home's replacement value. In 2003, Wells Fargo acquired Ms. *Feaz's* mortgage. Ms. *Feaz* continued to renew her flood insurance in the amount of \$63,000 until 2007, when Wells Fargo instructed her to increase her flood insurance coverage to the amount of her home's replacement value. When she failed to do so, Wells Fargo force-placed the insurance.

Thereafter, Ms. *Feaz* filed suit against Wells Fargo, alleging that it breached the mortgage contract by requiring her to obtain more flood insurance than what is mandated by federal law.<sup>1</sup> Specifically, *Feaz* argued that the covenant requiring her to "insure . . . against loss by floods to the extent required by the Secretary" of HUD limited the amount of flood insurance Wells Fargo could require her to obtain to the amount required by the Secretary. Stated differently, *Feaz* contended that because the Secretary requires flood-insurance coverage in the lesser of \$250,000 or the loan's principal balance, Wells Fargo could not require her to obtain more flood insurance than her loan's principal balance (which was less than \$250,000). Wells Fargo moved to dismiss the complaint, arguing that the covenant sets a floor, rather than a ceiling, on the amount of flood insurance

coverage that a borrower must obtain. The district court granted Wells Fargo's motion and dismissed Ms. Feaz's complaint. Ms. Feaz subsequently appealed.

Affirming the district court's ruling, the Eleventh Circuit three-judge panel held that the covenant "unambiguously makes the federally required flood-insurance amount the minimum, not the maximum, the borrower must have." Employing traditional contract-interpretation principles, the Court noted that the covenant allows a lender to set the required insurance for "any hazards," including but not limited to floods. In addition, the Court noted that the covenant "adds a separate and independent requirement that the borrower maintain the federally required minimum amount of insurance in addition to – not in lieu of – what the lender requires." The Court further noted that the mortgage contract allows the lender to "do and pay whatever is necessary" to "protect the value of the Property," which is not limited to the loan's principal balance, but rather, extends to the replacement value of the home.

The Court also noted that its interpretation of the covenant comports with the language of the regulatory scheme. Specifically, the Court pointed out that the HUD regulations require that a borrower obtain flood insurance in "an amount *at least* equal to either the outstanding balance of the mortgage . . . or the maximum amount of the [National Flood Insurance Program] insurance available with respect to the property improvements, whichever is less." The Court noted that the words "at least" are consistent with interpreting the covenant to allow the lender to require more insurance than HUD requires.

Turning to the context and purpose of the regulatory scheme, the Court noted that it is implausible to read the Covenant as imposing a ceiling on the amount of flood insurance a lender may require. The Court explained that when a borrower defaults on an FHA-guaranteed mortgage, the lender conveys the mortgage to the federal government and collects on the guarantee. If the property is damaged by flood, however, the lender cannot collect on the guarantee until it has repaired the damage or deducts the repair costs from the insurance benefits. The Court concluded that if the insurance amount is limited to the unpaid principal balance, as opposed to the property's replacement value, the lender would be forced to bear the cost of repairing the property in amounts that could exceed the insurance benefits. Accordingly, lenders would likely be reluctant to offer FHA-insured mortgages in high risk flood areas, or would pass on their increased risk of loss in the form of higher interest rates, which would undermine the FHA's purpose of encouraging affordable home ownership and the National Flood Insurance Program's purpose of encouraging adequate flood insurance.

Accordingly, with the resolve of the district court split on the issue of flood insurance coverage, it is now crystal clear that lenders are free to require higher flood insurance coverage from its borrowers pursuant to FHA-guaranteed mortgages. However, with the redrawing of federal flood hazard maps and proposed increased in premium rates for flood insurance, the jury is still out on the impact this holding will have on property owners within special flood hazard zones located in the coastal states and those borrowers' ability to refinance their loans.

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<sup>1</sup> Feaz also asserted claims for breach of implied covenant of good faith and fair dealing, as well as breach of fiduciary duty, under Alabama state law.