

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SJR 2098

SPONSOR: Banking and Insurance Committee and Senator Burt

SUBJECT: Florida Hurricane Catastrophe Fund

DATE: February 26, 2002      REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Deffenbaugh</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Favorable/CS</u>
2.	<u>Keating</u>	<u>Johansen</u>	<u>FT</u>	<u>Favorable</u>
3.	_____	_____	<u>AGG</u>	_____
4.	_____	_____	<u>AP</u>	_____
5.	_____	_____	<u>RC</u>	_____
6.	_____	_____	_____	_____

## I. Summary:

This Senate Joint Resolution proposes an amendment to the State Constitution, for approval or rejection by the electors, to limit the use of the assets of the Florida Hurricane Catastrophe Fund (FHCF or “fund”). The amendment generally tracks the requirement of the current statute by providing that the assets of the Florida Hurricane Catastrophe Fund must be used exclusively for paying catastrophic hurricane loss obligations arising out of reimbursement contracts with insurers, paying debt service on revenue bonds and financing arrangements issued by or on behalf of the fund, reinsurance costs of the fund, administrative expenses of the fund, and an annual appropriation for hurricane loss mitigation programs.

The proposed amendment also provides the same requirement as the current statute that an appropriation from the FHCF for hurricane loss mitigation programs may not exceed 35 percent of the fund’s investment income, and that at least \$10 million be appropriated annually. *However*, the amendment differs from the current law by requiring that the Legislature appropriate \$10 million from the FHCF (no more, no less) in the General Appropriations Act for hurricane loss mitigation programs, and that any additional appropriation from the fund for such programs must be approved by a vote of three-fifths of the membership of each house of the Legislature in a separate bill or bills for that purpose only.

The FHCF was created after Hurricane Andrew in 1993 as a form of mandatory reinsurance for residential property insurers. The FHCF is administered by the State Board of Administration (SBA) and is a tax-exempt source of reimbursement to property insurers for excess losses due to hurricanes. Since 1997, the Legislature has appropriated the minimum \$10 million each year for hurricane loss mitigation funding, until 2001 when the Legislature appropriated \$30 million for FY 2001-02.

This Senate Joint Resolution creates Section 20 of Article X of the State Constitution.

## II. Present Situation:

### Florida Hurricane Catastrophe Fund

After Hurricane Andrew, in a Special Session in November 1993, the Legislature created the Florida Hurricane Catastrophe Fund (FHCF or “fund”) to provide a mandatory form of reinsurance for residential property insurers in the state.<sup>1</sup> The FHCF is administered by the State Board of Administration and is a tax-exempt source of reimbursement to property insurers for excess losses due to hurricanes. The law limits the obligations of the FHCF to its claims paying capacity, not to exceed \$11 billion in any one year.

The SBA is required to enter into a reimbursement contract with each residential property insurer, and to establish the premiums that insurers must pay for their coverage from the fund. In doing so, the SBA must select an independent consultant to develop a formula for determining the actuarially indicated premium. Hurricane loss projection models found to be accurate and reliable by the Florida Commission on Hurricane Loss Projection Methodology must be used by the FHCF in establishing its premiums.<sup>2</sup>

Insurance company premiums for FHCF coverage have averaged about \$447 million annually, for all insurers combined, for each year’s coverage from 1995 through 2001. The fund also earns investment income and expends funds for administration and, to date, relatively small reimbursements to insurers (from Hurricanes Erin and Opal in 1995). On October 3, 2001, the SBA projected a 10/31/01 fund balance of \$4.31 billion. If necessary to pay the \$11 billion limit in annual reimbursement, the SBA would use these funds and issue \$6.69 billion in bonds, supported by an estimated 2.69 percent assessment on specified lines of property and casualty insurance policies.

The premiums that insurers are required to pay the FHCF are significantly lower than comparable levels of reinsurance in the private market. As such, the FHCF acts to lower premiums for residential property insurance as well as to expand reinsurance capacity which enables a greater amount of insurance to be written in the state.

Moneys in the FHCF may not be expended, loaned, or appropriated except to pay obligations of the fund arising out of reimbursement contracts, payment of debt service on revenue bonds, costs of mitigation programs, costs of procuring reinsurance, and costs of administration of the fund. The SBA must invest the moneys in the fund pursuant to the same laws that generally apply to investment of funds by the SBA under ss. 215.44-215.52, F.S.<sup>3</sup> In practice, the SBA has made relatively low-risk, highly liquid, fixed maturity investments for the FHCF, due to the need to timely reimburse insurers for hurricane losses.

### Hurricane Loss Mitigation Funding

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<sup>1</sup> Ch. 93-409, L.O.F.; s. 215.555, F.S.

<sup>2</sup> s. 627.0628(3)(b), F.S.

<sup>3</sup> s. 215.555(3), F.S.

The law directs the Legislature each fiscal year, beginning in fiscal year 1997-1998, to appropriate from the investment income of the FHCF at least \$10 million, but no more than 35 percent of the investment income from the prior fiscal year for the purpose of funding local governments, state agencies, public and private educational institutions, and nonprofit organizations to support hurricane loss mitigation programs intended to:

- Improve hurricane preparedness;
- Reduce potential losses in the event of a hurricane;
- Provide research into the means to reduce such losses;
- Educate or inform the public as to the means to reduce hurricane losses;
- Assist the public in determining the appropriateness of particular upgrades to structures or in the financing of such upgrades; or
- Protect local infrastructure from potential damage from a hurricane.<sup>4</sup>

These hurricane loss mitigation provisions were enacted in the 1995 act containing provisions determined by the Internal Revenue Service to be necessary in order for the FHCF to be an integral part of state government and not be taxable by the federal government.<sup>5</sup> One of the central elements was an expansion of the moneys available for a wider range of hurricane loss mitigation projects. The act required the minimum annual \$10 million appropriation, capped at 35 percent of investment income (a change from the law that allowed up to 2 percent of premium income to be used), and broadened the hurricane loss mitigation purposes.

Legislation in 1999 created the Hurricane Loss Mitigation Program and required that the \$10 million that must be appropriated from the FHCF for loss mitigation be appropriated to the Department of Community Affairs (DCA) for specified purposes. As currently required, \$7 million must be used for programs to improve the wind resistance of residences and mobile homes and \$3 million must be used to retrofit existing facilities used as public hurricane shelters. The law further directs that 40 percent of the \$7 million (\$2.8 million) be used to inspect and improve tiedowns for mobile homes and that 10 percent (\$700,000) be allocated to the State University System dedicated to hurricane research. This section is scheduled for repeal on June 30, 2006.<sup>6</sup>

### **History of Mitigation Funding; Impact on Premiums**

The Legislature began appropriating \$10 million in hurricane loss mitigation funds from the FHCF for the 1997-98 fiscal year, and for each of the next three fiscal years.<sup>7</sup> However, in 2001, the Legislature appropriated \$30 million in hurricane loss mitigation funds from the FHCF for FY 2001-02.<sup>8</sup> Even though the law allows an appropriation for hurricane loss mitigation

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<sup>4</sup> s. 215.555(7)(c), F.S.

<sup>5</sup> Ch. 95-1, L.O.F.

<sup>6</sup> s. 215.559, F.S.

<sup>7</sup> The Legislature appropriated \$12.2 million in 2000, but \$2.2 million accounted for amounts that were vetoed by the Governor in prior years.

<sup>8</sup> The 2001-02 General Appropriations Act (GAA) provided \$10 million to the Department of Community Affairs, of which \$3 million was provided to the Division of Emergency Management in line item #1543 for hurricane loss mitigation programs, and \$7 million was provided to the Division of Housing and Community Development in line items # 1605, 1606, and 1607A for hurricane loss mitigation programs. In addition, the GAA appropriated \$20 million to the Department of

programs in an amount up to 35 percent of investment income for the prior fiscal year, the law further provides that moneys in excess of \$10 million are not available for appropriation if the SBA finds that such an appropriation would jeopardize the actuarial soundness of the fund. This raises a “chicken and egg” problem, due to the fact that the SBA has historically established rates for the FHCF (in March for contracts beginning on June 1) prior to the time that the Legislature makes its annual appropriation for the upcoming fiscal year. The SBA has also historically established premiums that include exactly \$10 million designated for loss mitigation purposes. The remainder of the premium represents the actuarially determined amount necessary to pay the expected losses and expenses of the fund, based on conservative investment assumptions. Therefore, any amount appropriated in excess of \$10 million for loss mitigation would jeopardize the actuarial soundness of the fund unless the SBA increased the premiums to account for the excess appropriation. This is what occurred in 2001, when the SBA approved a \$20 million increase in FHCF premiums to achieve actuarial soundness, after the Legislature appropriated \$30 million from the FHCF for loss mitigation, rather than the \$10 million appropriated in prior years.

This \$30 million appropriation in last year’s budget raised concerns due to the impact on residential property insurance premiums. Insurers are expressly allowed to fully recoup FHCF premiums in the premiums they charge to residential property policyholders.<sup>9</sup> The additional \$20 million appropriation, which triggered a \$20 million increase in FHCF premiums (from about \$467 million to \$487 million), amounted to a 4.1 percent increase in FHCF premiums. On average, this equates to about a 0.54 percent increase in residential property insurance premiums.<sup>10</sup>

The maximum amount that may be appropriated each year from the FHCF for hurricane loss mitigation is 35 percent of the fund’s investment income for the prior fiscal year. For fiscal year 2000-01, investment income was \$221.2 million, 35 percent of which is \$77.4 million. For the current fiscal year 2001-02, investment income is expected to drop to about \$133 million, 35 percent of which is \$46.5 million. Another question of interpretation is which year’s investment income should be used to establish the 35 percent cap. It may be unclear whether the statutory reference to the investment income from the “prior fiscal year” refers to the year prior to the year for which the appropriation is made, or prior to the year during which the Legislature enacts the appropriation. If read to refer to the year prior to the year for which the appropriation is made, the Legislature must estimate the investment income for the fiscal year before it has ended. And, as 2001-02 demonstrates, it cannot be assumed that the later year will have greater investment income.

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Environmental Protection in line item 1747A, to be provided to the South Florida Water Management District for storm water/flood mitigation projects in the counties of Palm Beach, Broward and Miami-Dade.

<sup>9</sup> s. 627.062(5), F.S.

<sup>10</sup> The \$487 million FHCF premium is estimated to be about 13.2 percent of the total \$3.7 billion in Florida residential property insurance premiums. Therefore, if FHCF premiums are increased by 4.1 percent, residential property insurance premiums are estimated to increase by 13.2 percent x 4.1 percent, which equals 0.54 percent.

### III. Effect of Proposed Changes:

The Senate Joint Resolution proposes an amendment to the State Constitution, for approval or rejection by the electors, to limit the use of the assets of the Florida Hurricane Catastrophe Fund (FHCF). The amendment generally tracks the requirement of the current statute by providing that the assets of the Florida Hurricane Catastrophe Fund must be used exclusively for paying catastrophic hurricane loss obligations arising out of reimbursement contracts with insurers, paying debt service on revenue bonds and financing arrangements issued by or on behalf of the fund, reinsurance costs of the fund, administrative expenses of the fund, and an annual appropriation for hurricane loss mitigation programs.

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The proposed amendment also addresses an issue that may be unclear under the current law, by specifying that the relevant year for determining the investment income of the FHCF, for purposes of calculating the 35 percent cap, is the fiscal year that concluded 2 years before the effective date of the appropriation (as compared to "the prior fiscal year" as used in the current statute).

The proposed amendment also provides that it does not limit the authority of the Legislature to abolish or otherwise terminate the operations of the FHCF.

The proposed amendment effectively prohibits the Legislature from amending the current law to allow for FHCF funds to be used for any other purposes than those currently specified in the law. The proposed amendment uses, but does not define or expand upon the phrase, "hurricane loss mitigation programs." This is the phrase used in the current law, but the law includes specific types of programs which qualify as hurricane loss mitigation programs and requires allocation of \$10 million to the Department of Community Affairs for specified purposes, as described in Present Situation, above. These current law provisions do not appear to conflict in any way with the proposed constitutional amendment. The Legislature would continue to have relatively broad authority to determine what constitutes a hurricane loss mitigation program. But, the Legislature would be prohibited from amending the law to allow for any less than \$10 million to be appropriated annually for hurricane loss mitigation programs, or more than 35 percent of investment income of the fiscal year that concluded 2 years before the effective date of the appropriation.

**IV. Constitutional Issues:**

## A. Municipality/County Mandates Restrictions:

None.

## B. Public Records/Open Meetings Issues:

None.

## C. Trust Funds Restrictions:

None.

**V. Economic Impact and Fiscal Note:**

## A. Tax/Fee Issues:

None.

## B. Private Sector Impact:

Residential property insurers and their policyholders would be afforded greater protection, due to a state constitutional amendment, that the funds of the FHCF would be used only for those purposes currently authorized by general law. As such, the reinsurance coverage provided by the FHCF, which is significantly less expensive than private reinsurance and tends to lower residential property insurance premiums, would be protected from possible legislative changes that would allow funds to be used for other purposes. Similarly, hurricane loss mitigation funding above \$10 million may be less likely due to the requirement for a separate bill and super-majority vote.

## C. Government Sector Impact:

The Department of Community Affairs, the Department of Environmental Protection, and other agencies that may be appropriated funds from the FHCF for hurricane loss mitigation programs may be less likely to obtain total funding above \$10 million, due to the requirement for a separate bill and super-majority vote

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Amendments:**

None.

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This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.

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