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.)

Prepared By: General Government Appropriations Committee

BILL: SJR 98

INTRODUCER: Senator Alexander

SUBJECT: Florida Hurricane Catastrophe Fund

DATE: April 18, 2006 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Knudson	Deffenbaugh	BI	**Favorable**
2.	Kynoch	Hayes	GA	**Favorable**
3.			WM	
4.			RC	
5.				
6.				

I. Summary:

This bill 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") and to restrict legislative appropriations from the fund. As currently required by general law in s. 215.555, F.S, the constitutional amendment would require that the assets of the FHCF be used exclusively for paying catastrophic hurricane loss obligations arising out of reimbursement contracts with insurers, 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 constitutional amendment also provides substantially the same requirement as current law that at least $10 million be appropriated annually from the FHCF, up to a maximum of 35 percent of the fund's investment income, for hurricane loss mitigation programs. However, the amendment differs from current law by requiring that the Legislature appropriate exactly $10 million from the FHCF 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-fourths of the membership of each house of the Legislature in a separate bill or bills for that purpose only. The amendment provides the same requirement as current law that specifies the investment income of the FHCF is based on the most recent fiscal year-end audited financial statements for the purpose of calculating the 35 percent cap.

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. Initially, the Legislature appropriated an average of $10 million in hurricane loss

mitigation funding for each of the first four fiscal years beginning in Fiscal Year 1997-1998, after accounting for amounts vetoed by the Governor. The Legislature appropriated $30 million for Fiscal Year 2001-2002 and $20 million for Fiscal Year 2002-2003 ($19.075 million, net of vetoed amount), for such purposes. In Fiscal Years 2003-2004, 2004-2005, and 2005-2006, the Legislature appropriated $10 million each year. As currently structured, these appropriation amounts are added to the premium that the SBA charges insurers. The insurers, in turn, may recoup such amounts in the premiums charged to residential property insurance policyholders.

This bill creates Section 20, Article X of the State Constitution.

II. Present Situation:

Florida Hurricane Catastrophe Fund

Overview

The Florida Hurricane Catastrophe Fund was created in 1993 after Hurricane Andrew, as a form of mandatory reinsurance for residential property insurers.[1] All insurers who write residential property insurance in Florida are required to buy coverage from the FHCF to reimburse them for a portion of their residential hurricane losses. The fund is a tax-exempt state fund administered by the State Board of Administration that provides an additional source of reinsurance to insurers that is much less expensive than private reinsurance. This generally enables insurers to write more residential coverage in Florida than could otherwise be written and acts to lower premiums for consumers.

Retention

Each insurer must have hurricane losses that exceed its “retention” or deductible, before it is reimbursed from the fund. The law, as amended in 2004, established a $4.5 billion retention for all insurers combined for each hurricane, beginning with the June 1, 2004 contract year, subject to an annual growth factor equal to the percentage increase in the fund’s exposure. The retention for the 2006-2007 contract year is calculated to be $5.301 billion, which falls to one-third that amount ($1.767 billion) for the third largest hurricane and subsequent events. Separate retentions are calculated for each insurer based on the insurer’s percentage share of total premiums paid to the Fund.

Coverage Limits

The FHCF reimburses insurers above their retention for 90 percent, 75 percent, or 45 percent of their residential losses, as selected by the insurer. The maximum amount the FHCF is required to pay is $15 billion for the 2006-2007 contract year. The coverage limit is subject to the same annual growth factor as the retention, except that the limit cannot increase more than the dollar growth in the fund’s cash balance. Since the amount of the fund’s cash balance has decreased, the coverage limit has remained at $15 billion. Each insurer’s recovery in any year is limited to its percentage share of the total $15 billion (or greater) limit, equal to the insurer’s percentage of

[1] Section 215,555, F.S.

total fund premiums. However, if capacity remains after all insurers have been fully reimbursed, the fund must reimburse Citizens Property Insurance Corporation, the state insurer of last resort, for its reimbursable losses exceeding its share of the $15 billion limit.

Premiums

Each insurer pays a reimbursement premium approved by the SBA, which must be the “actuarially indicated” premium for the coverage provided, based on hurricane loss projection models found acceptable by the Florida Commission on Hurricane Loss Projection Methodology, and a premium formula developed by an independent consultant hired by the SBA. Each insurer’s reimbursement premium is based on the insured value of its residential policies, their location, construction type, deductible amounts, and other factors. For 2006, FHCF premiums paid by insurers are estimated to total $800.4 million. FHCF premiums are actually expected to decrease by 2.18 percent for the 2006-2007 contract year, but with total premium dollars collected increasing by almost $65 million.

Funding; Assessments

If the cash balance of the FHCF is insufficient to meet its obligations, the SBA is authorized to issue revenue bonds funded by emergency assessments levied as surcharges against all property and casualty insurance premiums paid by policyholders, other than for workers’ compensation and, until June 1, 2007, medical malpractice, and including surplus lines policyholders. Annual assessments (never yet levied) are capped at 6 percent of premium for losses from any one year and 10 percent of premium for losses from multiple years.

Current Financial Status; Impact of 2004 and 2005 Hurricanes

Based on April 2006 data, representatives from the FHCF estimate that the fund will experience a cash shortfall of $697 million dollars. Additionally, it is expected that the cash shortfall will grow substantially due to adverse loss development, perhaps resulting in a cash deficit of up to $1.297 billion. The FHCF has paid $3.5 billion of $3.8 billion in reported losses stemming from the 2004 hurricanes. The reported losses from the 2005 hurricanes are currently at $3.7 billion, of which $2.4 billion have been paid. However, the loss estimates for the FHCF from the 2005 storms are subject to adverse loss development and have continued to increase from earlier estimates.

Because the FHCF is not likely to have cash to carry over to fund claims resulting from the 2006 hurricane season, it will have to rely solely on premiums collected in 2006 to reimburse insurers for losses. This makes bonding more likely if the fund has to pay claims as a result of 2006 hurricanes. The fund’s anticipated premium revenue for 2006 is $800 million.[2] On April 4, 2006, the trustees of the SBA approved the 2006 FHCF premium formula to also include a 25 percent increase, known as a rapid cash buildup factor. This increase equates to $200 million in additional premium bringing the total FHCF premium to $1 billion. Premiums to the FHCF are paid by insurers in three installments, on June 1, October 1, and December 1, 2006. Thus, should

[2] Florida Hurricane Catastrophe Fund, *2006 Ratemaking Formula Report to the State Board of Administration* (March 27, 2006).

an early season hurricane occur, it may be necessary for the FHCF to borrow money to cover losses. For low amounts of losses, this could be done with a simple loan. For large amounts of loss, revenue bonds would need to be issued. The addition of a rapid cash buildup factor will allow the FHCF to reduce its potential shortfall.

In summary, from the inception of the fund in 1993 until the 2004 hurricane season, the fund paid insurers for claims for only two hurricanes: Hurricanes Erin and Opal in 1995. Until 2004, the amount the FHCF paid to insurers totaled approximately $13 million. Thus, going into the 2004 hurricane season, the FHCF had accumulated over $6 billion in cash. As a result of the 2004 hurricanes, the fund has spent or expects to spend almost $3.85 billion of its cash reimbursing insurers for hurricane losses. Going into the 2005 hurricane season, the fund’s cash had decreased to $3 billion. With reimbursement to insurers for 2005 hurricane losses expected to be $3.7 billion, the fund anticipates it may have to bond to pay claims and will start the 2006 hurricane season with no cash. Thus, it is important to note that the $6 billion it took the FHCF to accumulate over ten years was depleted in just two years.

Hurricane Loss Mitigation Funding

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 based upon the most recent fiscal year-end audited financial statements of the fund 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.
- Protect local infrastructure from potential damage from a hurricane.[3]

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.[4] One of the changes was an expansion of the moneys available for a wider range of hurricane loss mitigation projects. The 1995 act required the minimum annual $10 million appropriation, capped at 35 percent of investment income (a change from the prior law that allowed up to 2 percent of premium income to be used), and the act 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

[3] Section 215.555(7)(c), F.S.
[4] Chapter 95-1, L.O.F.

Department of Community Affairs for specified purposes.[5] 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 tie-downs 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, 2011.[6]

History of Mitigation Funding; Impact on Premiums

The following chart shows the annual appropriations from the FHCF and the amounts vetoed by the Governor:

FHCF Hurricane Mitigation Funding

FY	Total Appropriated by Florida Legislature	Vetoed by Governor
97-98	$10,000,000	$2,822,400
98-99	$12,500,000	$0
99-00	$10,300,000	$2,200,000
00-01	$12,200,000	$0
01-02	$30,000,000[7]	$0
02-03	$20,002,909[8]	$927,600
03-04	$10,000,000*	$0
04-05	$10,000,000	$0
05-06	$10,000,000	$0

*Not including $150 million appropriated for the Multiple Deductible Reimbursement Program, described below.

The $30 million appropriation in the Fiscal Year 2001-2002 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.[9] The additional $20 million appropriation, compared to the $10 million appropriation for each of the prior years, triggered a $20 million increase in FHCF premiums, which was a 4.1 percent

[5] Chapter 99-305, L.O.F.

[6] Section 215.559, F.S.

[7] The 2001-2002 General Appropriations Act (GAA) provided $10 million to the Department of Community Affairs, including $3 million to the Division of Emergency Management in line item 1543, and $7 million 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 Environmental Protection in line item 1747A, to be provided to the South Florida Water Management District for storm water/flood mitigation projects.

[8] In addition to a $10 million appropriation, the appropriations implementing bill (s. 29, ch. 2002-394, L.O.F.) amended s. 215.555(16), F.S., to provide that, for the 2002-2003 fiscal year only, the SBA must disburse funds from the FHCF to the Ecosystem Management and Restoration Trust Fund of the Department of Environmental Protection in an amount equal to 8.47 percent of the appropriation made from that trust fund for "Grants and Aids to Local Government and Non-State Entities - Fixed Capital Outlay, Statewide Restoration Projects" in the 2002-2003 GAA. The grants from this trust fund totaled $118,098,333. The Governor vetoed item 1769, which totaled $10,951,833; in effect, 8.47 percent of this amount, or $927,600, was the portion of the vetoed amount from the FHCF.

[9] Section 627.062(5), F.S.

increase. On average, this resulted in about a 0.54 percent increase in residential property insurance premiums, assuming insurers recovered this amount in their approved rate filings.[10] In developing the premium formula for the 2002-2003 fiscal year, before the legislative appropriation was known, the SBA approved rates based on various levels of mitigation, ranging from $10 million to $50 million in increments of $5 million. Net of the vetoed amount, the $19.075 million appropriation resulted in a decrease in FHCF rates, compared to the $30 million appropriation for the prior year (taking into account only the mitigation funding). However, the rates were higher than they would have been, had only $10 million been appropriated.

In Special Session 2004-A, the Legislature appropriated up to $150 million from the FHCF for the Department of Financial Services (department) to reimburse residential property insurance policyholders whose property was damaged by two or more hurricanes and whose insurer applied more than one hurricane deductible, up to specified limits. However, the department reports that the actual amount to be reimbursed was less than $70 million. In order to maintain actuarially indicated premiums, the State Board of Administration must increase future premiums to insurers for FHCF coverage over a five-year period to account for the amount that is expended.

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. The following chart shows the investment income earned by the fund each year since its inception, and 35 percent of each year’s amount:

FHCF Investment Income

Fiscal Year	Investment Income	35 Percent of Investment Income
94-95	$20,183,000	$7,064,050
95-96	$46,379,000	$16,232,650
96-97	$74,425,000	$26,048,750
97-98	$109,979,000	$38,492,650
98-99	$132,516,000	$46,380,600
99-00	$173,839,000	$60,843,650
00-01	$220,915,000	$77,320,250
01-02	$122,535,000	$42,887,250
02-03	$104,939,000	$36,728,650
03-04	$58,127,000	$20,344,450
04-05	$108,672,000	$38,035,200

As demonstrated by fiscal years 2001-2002 through 2003-2004, it cannot be assumed that investment income will increase from year to year.

[10] The $487 million FHCF premium in 2001 was estimated to be about 13.2 percent of the total $3.7 billion in Florida residential property insurance premiums. Therefore, if FHCF premiums were increased by 4.1 percent, residential property insurance premiums were estimated to increase by 13.2 percent x 4.1 percent, which equals 0.54 percent.

III. Effect of Proposed Changes:

The bill 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 and to restrict legislative appropriations from the fund. As currently required by general law in s. 215.555, F.S, the constitutional amendment would require that the assets of the FHCF 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 substantially 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 current law by requiring that the Legislature appropriate exactly $10 million from the FHCF 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-fourths of the membership of each house of the Legislature in a separate bill or bills for that purpose only.

The proposed amendment also clarifies a question of interpretation of the current statute, 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 two years before the effective date of the appropriation (as compared to "the prior fiscal year" as used in the current statute). For example, if the effective date of the appropriation is July 1, 2005, then June 30, 2004 would be the fiscal year that concluded two years before the effective date of the appropriation. This would allow for the use of fiscal year-end audited financial statements when determining investment income, rather than relying on estimates.

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

The proposed amendment, in effect, prohibits the Legislature from amending the current law to allow for FHCF funds to be used for any other purposes than those specified in the amendment, which are substantially the same purposes currently expressed in s. 215.555, F.S. 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 statute, but the statute also specifies 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 *II. Present Situation*, above). These current law provisions do not appear to conflict with the proposed constitutional amendment's limitations to use funds for hurricane loss mitigation programs. The Legislature would continue to have relatively broad authority to determine what constitutes a hurricane loss mitigation program. However, 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 two years before the effective date of the appropriation. In addition, exactly $10 million must be appropriated in the General Appropriations Act for such programs, and separate bill or bills subject to super-majority voting requirements would be required for appropriations in excess of this amount.

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 requirement that the funds of the Florida Hurricane Catastrophe Fund (FHCF) 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, which could negatively impact the availability of residential property insurance in the state. Similarly, hurricane loss mitigation funding above $10 million may be less likely due to the requirement for a separate bill and super-majority vote, which lessens the chances of residential property insurance premiums being increased as a result of such additional appropriations.

Conversely, the bill negatively impacts any potential private sector beneficiary of appropriations from the FHCF beyond those purposes currently authorized by statute, or of appropriations in excess of $10 million.

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. Summary of Amendments:

None.