The Florida Senate

Interim Project Report 2000-22 *September 1999*

Committee on Comprehensive Planning, Local and Military Affairs — Senator Lisa Carlton, Chairman

FUNDING FOR THE HURRICANE LOSS MITIGATION PROGRAM

SUMMARY

This report reviews current hurricane loss mitigation program funding issues. This report updates Report Number 97-P-10, issued by the Senate Committee on Banking and Insurance, October 1, 1997.

This report:

- reviews chapters 93-409 and 95-1, Laws of Florida, which established and amended the Cat Fund;
- identifies and reviews mitigation projects funded by the Cat Fund since 1997;
- discusses vetoes of Cat Fund appropriations and its effect on the tax status of the fund;
- reviews Interim Project 98-51, which recommended a formal process be established for recommending projects to be funded by the Legislature;
- reviews legislation considered in the 1999 Legislative Session which would have created a process for reviewing and prioritizing legislative funding requests;
- reviews ch. 99-305, Laws of Florida, which directs the Legislature to annually appropriate $7 million from the Cat Fund to the Department of Community Affairs (DCA) to fund hurricane mitigation projects; and
- offers related findings and recommendations.

BACKGROUND

The Cat Fund

The Florida Hurricane Catastrophe Fund (hereafter, the “Cat Fund”), was created in 1993 in response to the disruption of the property insurance market following Hurricane Andrew in August 1992. During the November 1993 Special Session, the Legislature enacted a number of property insurance and solvency-related measures, including ch. 93-409, Laws of Florida, which created a state reinsurance fund to reimburse insurers for a portion of their hurricane losses in the state. The purpose of the Cat Fund is to provide additional reinsurance capacity, thereby increasing the amount of property insurance that insurers are able to write and enabling insurers to pay all claims in full in the event of a hurricane. [s. 215.555(1), F.S.]

The Cat Fund is administered by the State Board of Administration (SBA) which reimburses all residential property insurers in the state for 45, 75, or 90 percent of their hurricane losses, as selected by the insurer, above a certain retention. The retention is the amount of losses that the insurer must pay before the Cat Fund begins reimbursement. Each insurer’s retention is set at a multiple of its Cat Fund premium which, for all insurers combined, equates to an industry-wide retention of about $3.1 billion. All residential property insurers in Florida are required to pay a reinsurance premium to the Cat Fund for this coverage, estimated to be $437 million for all insurers combined for the current (1999) contract year with a projected year-end balance of $3.1 billion, barring any hurricane reimbursement payments. The fund estimates that it will be able to obtain an additional $7.9 billion through the issuance of bonds, thereby providing $11.0 billion in reinsurance capacity, secured by up to a 4 percent surcharge on all property and casualty policies in Florida, except workers’ compensation, accident and health. Legislation enacted in 1999 limits the total amount the Cat Fund may reimburse all insurers for hurricane losses to $11 billion for any one year. (ch. 99-217, Laws of Florida)

Tax-Exempt Status of the Cat Fund

The law expressly provides that it is essential to the functioning of a state program to increase insurance capacity, and that revenues received be exempt from federal taxation. For this reason, the program is structured as a state trust fund under the direction and control of the SBA, operating exclusively for the purpose of protecting and advancing the state's interest in maintaining insurance capacity in this state. [s. 215.555(1)(f), F.S.]

The 1993 legislation that created the Cat Fund required the SBA to request an expedited opinion from the Internal Revenue Service (IRS) as to the state's tax-exempt status with respect to fund revenues. The SBA hired outside tax counsel and entered into discussions and negotiations with the IRS regarding this issue. These negotiations resulted in identification of the legislative changes determined by the IRS to be necessary in order for the Cat Fund to be an integral part of state government and not be taxable by the federal government. The three central elements were:

- an expansion of the moneys available for a wider range of hurricane loss mitigation projects;

- an initial state capital contribution from a broad-based revenue source; and

- an increase in the broad-based emergency assessments that support the fund when premium revenues are insufficient.

These provisions were incorporated into the first act passed during the 1995 Regular Session (ch. 95-1, Laws of Florida), which made the following changes:

- Mitigation Funding: The act required the Legislature to annually appropriate from the fund no less than $10 million but no more than 35 percent of investment income from the prior year (a change from the prior law which allowed for up to 2 percent of premium income from the prior year to be used). The act delayed funding of mitigation programs until FY 1997-98, but expanded authorized uses for mitigation funding to include funding of local governments, state agencies, public and private educational institutions, and nonprofit organizations to support programs intended to improve hurricane preparedness, reduce potential losses in the event of a hurricane, provide research into hurricane loss reduction, educate or inform the public as to means to reduce hurricane losses, assist the public in determining the appropriateness of structural upgrades or in the financing of structural upgrades, or protect local infrastructure from potential damage from a hurricane. The amount available for appropriation is limited to $10 million if the SBA finds that the appropriation of investment income in excess of this amount would jeopardize the actuarial soundness of the fund.

- Initial State Capital Contribution: The act appropriated to the Cat Fund $25 million in FY 1995-96 and $25 million in FY 1996-97 ($12.5 million from General Revenue and $12.5 million from the Insurance Commissioner's Regulatory Trust Fund each year).

- Emergency Assessments (Broad-Based Funding Source): The act authorized the SBA to increase the emergency assessment on all property and casualty insurance policies (except workers' compensation, accident and health) from 2 percent to an amount not exceeding 4 percent of the gross direct written premiums if the Governor has declared a state of emergency due to the occurrence of a hurricane.

Cat Fund Mitigation Projects

Since FY 1997-98, the Legislature has appropriated $32.8 million ($27.7 million net, after gubernatorial vetoes) from the Cat Fund for mitigation projects. [See TABLE 1 on pg. 4]

Beginning in FY 1997-98, the Legislature has appropriated a total of $11.5 million from the Cat Fund to the Division of Emergency Management (division) to be used as state matching funds for hazard mitigation **projects associated with natural disasters**. The criteria used by the division to make funding decisions provide that the mitigation projects must be consistent with the federal Hazard Mitigation Grant Program objectives. The objectives are:

- to prevent future losses of lives and property due to disasters;

- to implement State or Local Hazard Mitigation Strategies;

- to enable mitigation measures to be implemented during immediate recovery from a disaster; and

- to provide funding for previously identified mitigation measures that benefit the disaster area.

The mitigation projects funded under the Emergency Management/Disaster Relief appropriations are related to the following disasters:

Hurricane Opal	$ 4,041,169
El Nino Events	$ 3,936,634
Groundhog Day Storm	$ 376,286
1998 Wildfires	$ 670,378
Hurricane Earl	$ 25,740
Hurricane Georges	$ 2,363,420
Tropical Storm Mitch	$ 127,542
	=========
	$11,541,169

DCA reports that all $11.5 million has been allocated, approximately $3.6 million has been approved and encumbered by contractual agreement, and approximately $640,000 in reimbursement requests have been disbursed.

The Legislature has funded, for FY 1997-98 and FY 1998-99, a total of $5.6 million from the Catastrophe Fund for the **Residential Construction Mitigation Program** (RCMP). This pilot program was developed by DCA to meet seven goals:

- to increase public awareness through an aggressive public education program;
- to educate homeowners on practical and affordable retrofit opportunities;
- to promote the use of sound residential retrofitting and mitigation methods and materials within the construction industry;
- to offer an accredited retrofit/mitigation program for inspection and construction professionals;
- to promote ongoing research and development of new retrofit/mitigation techniques and alternatives;
- to develop economic incentives for homeowners to upgrade their homes for wind resistance; and
- to minimize insured loss exposure, and establish more insurance credits via data base analysis.

Year-to-date summaries of expenditures for FY 1997-98 & 1998-99, as reported by DCA, include:

Residential Retrofit Contracts	$3,754,755
Education/Marketing Contracts	$ 740,784
Research/Engr. Analysis Contracts	$ 864,762
	=========
	$ 5,360,301

The International Hurricane Center, Florida International University, included a review of the RCMP in *An Academic Review of Breaking the Cycle*, issued January 1999. The review is based on the first year of the pilot program and evaluated the extent to which progression was made toward the seven original goals. The report states that:

> the success of the program to date is mixed . . . This first year has been one of trial and error, resulting in considerable confusion and frustration at both the state and county levels.

However, the report concludes that:

> In general, we are amazed at what has been accomplished by this pilot program. In the last few months many of the glitches have been worked out and it seems to be proceeding well. A great deal of time and effort has gone into its development and we strongly recommend that the RCMP be continued in the pilot counties, perhaps extending to Monroe County and coastal communities in the panhandle.

The review identifies two significant positive outcomes of the program:

- the creation of an extensive database of housing characteristics which should prove valuable in a variety of mitigation research and development activities; and
- the development of a program designed to provide households with impartial information on how they can retrofit their homes to make them more hurricane resistant.

The review makes thirteen recommendations for improving the program and states that many of the recommendations have already been identified by those responsible for the program. The most significant recommendation states that:

> Serious thought needs to be given to the issue of what type of homeowner the RCMP should be targeting. If the primary goal is to get higher homes

out of the windstorm pool, then the current criteria are the right ones. However, if the goal is to reduce the risk of as many Florida households as possible, then future RCMP funds could be more effectively used to purchase mitigation, such as hurricane shutters, for more homes, particularly those who cannot otherwise afford them.

While the Governor vetoed the $2.82 million appropriation for **Sand Dune Restoration / Beach Projects** in FY 1997/98, the $2.5 million appropriated in FY 1998/99 for the same projects was allowed to remain. The Juno Beach Restoration project received $1.9 million and the Ponce DeLeon Inlet Management Plan project received $582,598. Both projects are currently in the contract stage.

TABLE 1: CAT FUND MITIGATION PROJECTS

Appropriated Projects	FY 1997-98		FY 1998-99	FY 1999-00		Total
	Appro.	**Net**	**App. & Net**	**Appro.**	**Net**	**Net**
Emergency Management - Disaster Relief	$4,041,169	$4,041,169	$7,500,000			$11,541,169
Residential Construction Mitigation (Wind Resistance)/Loans	$3,136,431	$3,136,431	$2,500,000	$1,185,000	$1,185,000	$6,821,431
Sand Dune Restoration/Beach Projects	$2,822,400	0	$2,500,000			$2,500,000
Unified Building Code Implementation				$1,650,000	$1,650,000	$1,650,000
Public School Hurricane Mitigation and Protection - Statewide				$2,265,000	$2,265,000	$2,265,000
Mobile Home Safety				$2,000,000	$2,000,000	$2,000,000
CDBG Mitigation Program				$1,000,000	$1,000,000	$1,000,000
Public School Hurricane Mitigation and Protection - Osceola				$1,000,000	0	0
Underground Utilities Demo Project- Winter Park & Clearwater				$400,000	0	0
Underground Utilities Demo Project- Davis Island				$400,000	0	0
Underground Utilities Demo Project- City of Miami Beach				$400,000	0	0
TOTAL Note: 0 = Governor's Veto	**$10,000,000**	**$7,177,600**	**$12,500,000**	**$10,300,000**	**$8,100,000**	**$27,777,600**

Vetoes of Cat Fund Appropriations and the Tax Status of the Fund

The requirement that at least $10 million be appropriated annually from the Cat Fund for hurricane loss mitigation purposes was one feature of the 1995 act that secured a ruling from the IRS that Cat Fund revenues are not subject to federal taxation.

On May 28, 1997, Governor Chiles vetoed the $2.8 million appropriation in Line Item 1273 related to the eight sand dune restoration projects. The veto message stated, “Funding of these projects from these funds would set the wrong precedent; these funds should be for the purpose of enhancing residential mitigation.” These moneys were re-appropriated for other projects by the Legislature in the next legislative session.

On May 27, 1999, Governor Bush vetoed $2.2 million for projects relating to public school hurricane mitigation and protection for Osceola County and underground utility demonstration projects for the Cities of Miami Beach, Winter Park and Clearwater, and Davis Island. As for the public school mitigation project, the Governor stated the following:

> Specific Appropriation 1118A provides funding for a statewide plan for hurricane mitigation and protection for public schools designated as hurricane shelters for one county. Since hurricane

> preparation is a statewide concern, specifying the level of funding for one county without evaluating the overall statewide need in a strategic fashion appears to be unfair . . .

As for the underground utility demonstration projects, the Governor stated the following:

> Over the last several years the state has faced a staggering number of natural disasters. Florida's citizens have been forced to deal with hurricanes, floods, tornados, wildfires, and droughts. The loss in lives and property damage has been enormous. To help meet local emergency management needs, the Legislature enacted the Emergency Management and Assistance Grant Program. This is a competitive program that provides funds to local governments for facility and equipment upgrades to help prepare for, and more effectively respond to, natural disasters. The projects appropriated in the Legislature's budget were not evaluated through the established competitive process. While these projects may have merit, approving them would be a circumvention of the established review process, and an unjustified waiver of the standards by which other similar projects are evaluated.

The primary issue for consideration is whether the vetoes of the appropriations from the Cat Fund affect the tax-exempt status of the fund. [See discussion in FINDINGS] A secondary issue relates to the likelihood that future projects funded from the Cat Fund will be vetoed because they fail to meet the Governor's criteria for inclusion in the State Budget.

Interim Project Report 98-51

In 1998, the Senate Committee on Ways and Means issued a report contending that over the past several years, local governments and non-profit institutions have exerted greater pressure upon the Florida Legislature for financial assistance with special projects. For many of these projects, there is no formal funding process set forth in statutes and the Legislature is left to address these requests on an individual basis, often with incomplete or no standardized information. This makes it particularly difficult for legislators, who are required to make funding decisions usually within limited resources.

The report noted that there is already a process set in statutes for the review and prioritization of grants for Historical Preservation, Cultural Facilities, Library Construction, the Florida Recreational Assistance Program, and International Trade. The report recommended that this concept be expanded to include several other areas of the state budget, to include multi-use facilities, festivals, agricultural centers, fairs, livestock pavilions, county court houses, and economic development projects. The report also noted that at least four factors need to be addressed for the creation of a grant application and review process:

- the entity to be designated to review, prioritize, and make the initial recommendations for projects, and the entity to make the final recommendation of a project list to the Legislature (may be the same entity);

- financial match requirements (if applicable);

- criteria considerations; and

- timing (application submission, review procedure, and recommendations to the Legislature).

The 1998-99 General Appropriations Act established a review committee for agricultural centers, fairs, livestock pavilions, multi-use facilities and festivals. The purpose of the committee was to evaluate projects funded for FY 1998-99, review all grant funding requests for FY 1999-00, and make recommendations in priority order. The Governor, President of the Senate, and the Speaker of the House of Representatives appointed two members each to the committee. The committee appointed one member and elected a chairperson. The committee met and developed recommendations. The Appropriations Committees considered the review committee's recommendations in compiling their list of member projects. However, the Governor vetoed projects that did not require at least a fifty percent funding match from local entities.

1999 Legislation to Establish Project Review and Prioritization Procedures

In the 1999 Legislative Session, a number of bills were introduced to create the recommended four-stage process for reviewing and prioritizing legislative funding requests for different categories of projects. For example, the review process for community centers contained in CS/CS/SB 386 consisted of the following stages:

- A county, city, or qualified not-for-profit corporation submits to a review panel a grant proposal for a matching grant for the acquisition, renovation, or construction of a community center.

The state grant may be for up to 75% of the project cost, with a cap of $1.5 million per project. The applicant must demonstrate that the community supports the project and that local funds are available and committed to operate and maintain the project.

- The review panel (consisting of two persons appointed to staggered terms by the Governor, President of the Senate, and Speaker of the House, respectively, and a seventh person appointed jointly by the panel) must review each application and submit, in priority order, a list of approved applications to the Secretary of DCA.

- If the Secretary approves the list, it will then be included, in priority order, in the department's legislative budget request. The department must give preference to projects located in Enterprise Zones and communities that have fewer than one community center per 35,000 residents.

- DCA may then accept and administer the funds appropriated by the Legislature for approved projects. Unfunded projects will then be retained for the next grant cycle. If the project is not funded in the second year, the project must be resubmitted for consideration.

The bill clarified that up to 10 percent of any grant funds appropriated for community centers may be used by the DCA for administrative purposes. The bill required the department to submit an expenditure plan for the administrative costs which would be subject to the review and approval provisions in s. 216.177, F.S. Grants were to be limited to 36 months. DCA was required to adopt, by rule criteria, to be applied by the review panel for administering this process.

While the bill passed the Senate, it died in House Messages.

Chapter 99-305, Laws of Florida

In 1999, the Legislature created the Hurricane Loss Mitigation Program (ch. 99-305, Laws of Florida). The law directs the Legislature to annually appropriate $7 million from the Cat Fund to DCA to fund programs to improve the wind resistance of residences and mobile homes, including loans, subsidies, grants, demonstration projects, and direct assistance; cooperative programs with local governments and the Federal Government; and other efforts to prevent or reduce losses or reduce the cost of rebuilding after a disaster.

DCA is required to develop these programs in consultation with an advisory council appointed by the secretary consisting of representatives of the following:

- Department of Insurance;

- Home builders;

- Insurance companies;

- Federation of Mobile Home Owners;

- Florida Association of Counties; and

- Florida Manufactured Housing Association who is a mobile home manufacturer or supplier.

The law requires that at least 40 percent of the total appropriation ($7 million) must be used for mobile homes, including programs to inspect and improve tie-downs, construct and provide safety structures, and provide other means to reduce losses. This allocation is reduced from 40 percent to at least 30 percent in the second year of the program, and at least 20 percent in the third and subsequent years. [While not using the formula required in this law, the Legislature appropriated $2 million in Cat Fund revenues and $1.8 million in General Revenue for these purposes in the 1999-00 budget.]

Ten percent of the appropriation must be allocated to the Board of Regents to be used by a Type I Center within the State University System dedicated to hurricane research, to support programs of research and development relating to hurricane loss reduction devices and techniques for residences and mobile homes and relating to the development of credible data on potential loss reductions.

Funds provided to DCA are intended to supplement, but not supplant other funding sources of the department.

DCA is required to provide to the Speaker of the House of Representatives, the President of the Senate, and the Majority and Minority Leaders of the House and Senate, a full report, accounting, and evaluation of activities funded under this law on January 1st of 2001 and 2002.

The law takes effect July 1, 2000, and applies to FY 2000-01 and 2001-02 budgets. The act is repealed June 30, 2002.

METHODOLOGY

The law creating s. 215.555, F.S., and all laws amending this section, and s. 215.599, F.S., were reviewed. Appropriations of Cat Fund monies were compiled and reviewed. Reports 97-P-10 and 98-51 were reviewed and summarized. SBA staff was interviewed. CS/CS/SB 386 from the 1999 Legislative Session was analyzed. Chapter 99-305, Laws of Florida, was analyzed.

FINDINGS

Vetoed Cat Fund Projects

Although it can be argued that the Legislature met its statutory obligation of appropriating $10 million from the Cat Fund, the vetoes resulted in less than the full $10 million actually being allocated. In 1997, the Chief Operating Officer of the Cat Fund and the Cat Fund Advisory Council recommended that the $2.8 million vetoed be re-appropriated by the Legislature out of the 1997-98 budget so that the tax-exempt status of the fund not be threatened. These moneys were re-appropriated for other projects over the next two legislative sessions. Likewise, the statutory requirement of annually appropriating at least $10 million from the Cat Fund may be met by a current fiscal-year appropriation of $2.2 million, effective at any time prior to the end of the current FY, June 30, 2000, and an additional $10 million appropriation for FY 2000-01.

To maintain the tax-free status of the fund, the Legislature should reappropriate the $2.2 million appropriation from the Cat Fund that was vetoed by the Governor.

Selection of Cat Fund Mitigation Projects

The current law requires appropriations from the Cat Fund, as follows:

> *Each fiscal year, the Legislature shall appropriate from the investment income of the Florida Hurricane Catastrophe Fund an amount no less than $10 million and no more than 35 percent of the investment income from the prior fiscal year for the purpose of providing funding for local governments, state agencies, public and private educational institutions, and nonprofit organizations to support programs intended to improve hurricane preparedness, reduce potential losses in the event of a hurricane, provide research into means to reduce such losses, educate or inform the public as to 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. . . .* [s. 215.555(7)(c), F.S.]

This language essentially limits the use of funds to reducing potential hurricane losses and improving hurricane preparedness. Funding projects that do not serve these purposes would not be consistent with expressed legislative intent. It should be noted that the 1995 amendments to the Cat Fund, which secured tax-exempt status for the fund, actually expanded the statutory scope of authorized projects from the original law. In general, the tax-exempt status was enhanced by a broader use of funds that continue to serve a valid public purpose but which do not necessarily benefit the insurers who contribute to the fund. Therefore, a reasonably broad interpretation of the statutory purposes for use of mitigation funds is not inconsistent with, and would not appear to threaten, the tax-exempt status of the fund. A broad interpretation of the purposes also provides more opportunities for the Legislature to relieve the demands on using General Revenue funds on needed public projects, if funds from the Cat Fund can reasonably be substituted.

Therefore, an argument is also made for funding those projects that can be expected to have the greatest impact in reducing hurricane losses to insured residential property, so that the benefit will translate into reducing Cat Fund losses, reducing the direct losses of residential property insurers, and reducing premiums for residential property insurance to homeowners, mobile homeowners, tenants, and condominium and apartment owners and residents. As noted in Report #97-P-10, this has generally been the position supported by the Cat Fund Advisory Council, insurers writing residential property insurance that pay Cat Fund premiums, the DCA, and the Department of Insurance. This position has less to do with protecting the tax-exempt status of the fund than it does with policy considerations of equity and effectiveness. The general consensus of the Cat Fund Advisory Council, as summarized by the Chief Operating Officer of the Cat Fund, is that the mitigation dollars be spent for the <u>benefit of</u> residential policyholders, which could include research, public education, grants or loan programs, and to this purpose mitigation dollars be spent <u>effectively</u> with governmental oversight, monitoring and control, with some type of audit review.

To satisfy the Governor's desire that projects be objectively evaluated, it may be useful for the Legislature to create a formal process for evaluating and selecting hurricane mitigation projects to be funded. It may also be useful to require performance evaluations of funded projects.

The New Funding Formula for Mitigation Projects

While the Legislature may not be bound by the new funding formula specified in ch. 99-305, Laws of Florida, it should consider the merits of the requirement when annually appropriating Cat Fund revenues.

RECOMMENDATIONS

#1 The Legislature appropriate the $2.2 million from the Cat Fund that was vetoed by the Governor, and make a $10 million appropriation from the Cat Fund for FY 2000-01.

#2 Beginning in FY 2001-02, the Legislature appropriate $7 million pursuant to the new funding formula specified in ch. 99-305, Laws of Florida.

#3 In making future appropriations from the Cat Fund, the Legislature give priority to those programs that will benefit residential property insurance policyholders and which are the most effective in reducing hurricane losses, and that reports or audits of approved programs be provided to the Legislature to document the program's results. In addition, the Legislature should create a process for reviewing and prioritizing funding requests for hurricane mitigation projects.

#4 Beginning in FY 2000/01, the Legislature should require performance evaluations of projects funded by Cat Funds.

COMMITTEE(S) INVOLVED IN REPORT ***(Contact first committee for more information.)***
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MEMBER OVERSIGHT
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