Panelist convey their views on the high cost and lack of available property insurance in Florida during a plenary session at the Coaliton's conference

Tackling the Property Insurance Monster

By Mark Hendrickson

Florida's homeowners, homebuyers, and apartment owners all face an unprecedented crisis in obtaining and/or affording property insurance. The major reason is straightforward—our state was hit with a multitude of hurricanes in little over one year. The result—over 2.6 million claims with over $35 billion paid by insurers. The reaction of the insurance companies to these claims and losses has been to raise rates and reduce their exposure in Florida by cancelling policies.

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The rate increases have been dramatic, almost doubling in many cases. For restricted rent affordable housing apartments, rents can only be raised as median income increases—so there is no way to recoup the unexpected expense. This can take a deal that was performing adequately and take it under water—with operating expenses now exceeding rental income. While a developer may feed the deal for some short period of time, existing deals cannot continue to operate in the red, and new deals that would have worked no longer show ability to cash flow.

The same is true for small "mom and pop" apartments, which are not rent restricted but still serve as an essential part of our affordable housing stock. These owners are faced with either increasing rents to levels that are no longer affordable to the residents, or selling the property for higher end development.

For homebuyers, the increase in property insurance rates limits their ability to borrow. With the increased payments included in the debt ratios, potential homebuyers cannot afford to buy the same home they could a year ago without significant additional subsidy to write down the mortgage amount. Existing homeowners face increased monthly payments that they may not be able to afford—or worse, cannot obtain insurance if their policy is cancelled.

At the Florida Housing Coalition's Conference in September, I moderated a distinguished panel of experts who came together to address this crisis. This article presents their perspectives on three important questions:

1. **Why are we in the crisis?**
2. **What are the best solutions to the crisis?**
3. **What potential solutions have they heard about that they believe don't make sense?**

Interviews were conducted with:

- **Lloyd Boggio,** the co-founder, Principal and Chief Executive Officer of The Carlisle Group, Inc., a leading developer of affordable apartments in Florida;

- **Sam Miller,** executive vice president of the Florida Insurance Council, the state's largest insurance company trade association with 250 members;

Continued on page 16

- **John Pisula,** head of the Public Affairs Department of State Farm Insurance, one of the largest providers of property insurance in Florida;

- **Steve Burgess,** the State Insurance Office's Insurance Consumer Advocate, a position with the authority to initiate or participate in any issue or filing that comes before the Office of Insurance Regulation or the Department of Financial Services;

- **Bill Newton,** Executive Director of the Florida Consumer Action Network, (FCAN), a statewide nonprofit consumer organization that advocates on issues including insurance, utilities, health care and the environment;

1. WHAT IS YOUR TAKE ON THE PROPERTY INSURANCE CRISIS TODAY? WHY ARE WE IN CRISIS?

Miller: We have a hurricane crisis because of eight hurricanes in 15 months, [leading to] 2.6 million claims, $35 billion in claims paid by insurers, plus another $4 billion absorbed by consumers through their deductibles. [These losses and] the probability that these kinds of huge hurricane losses will occur every few years if not annually for the next 10 to 20 years [are the reasons for the crisis]. We did manage to come up with the $35 billion, but it depleted the Florida hurricane catastrophe fund, put Citizens Property Insurance Corporation into a deep deficit and depleted the surpluses and profits accumulated by private carriers in the years following hurricane Andrew.

We are faced now with huge rate increases that are very difficult for consumers to absorb, but necessary if we are to pay hurricane claims the next time around. The major cost driver is the worldwide, private reinsurance market, charging two and three times what it did a year ago. [Insurance] carriers must have reinsurance and must pay what this unregulated market demands. They must pass on these costs to policyholders.

Boggio: We are in a crisis because of unprecedented hurricane activity, in Florida and elsewhere. There is no property insurance crisis; there is a windstorm insurance crisis. Insurers and reinsurers have sustained unsustainable losses, and have decided not to do so again.

Pisula: The property insurance situation in Florida has been in turmoil since Hurricane Andrew hit in 1992. Through the 1990's, the only positive measure that has had any long-term positive effect was the creation of the Florida Catastrophe Fund (CAT Fund). Through the 1990's, the leaders in Tallahassee artificially kept the rates of insurance from meeting the true actuarial levels. In fact, legislative committees recognized that even the old FWUA -- windstorm coverage -- was not charging the correct amount, but they did not want to make the tough decisions for political reasons. This did not encourage additional companies to enter the market. Instead, it sent a signal that companies would have to accept lower than actuarial correct rates. We have a true hurricane crisis, not an insurance crisis.

Burgess: The fundamental problem causing Florida's insurance crisis is the current lack of reasonably priced capital available to cover potential hurricane losses.

A large part of the capital that Florida relies on is provided by private reinsurance companies. Reinsurance is the "insurance for insurance companies." The Florida Office of Insurance Regulation (OIR) regulates the price that direct writers charge Florida residents, but OIR does not have regulatory authority over the reinsurance transaction. Given all the variables, the supply and demand are balanced in favor of the suppliers (reinsurance companies) being able to change very high prices for the use of capital.

The major factors that contribute to the current balance (imbalance) in the supply and demand for capital available to cover Florida's potential hurricane losses include (1) Increased value and density of property subject to destruction or damage from a single event or a single season, (2) A general recognition that the amount of possible destruction is considerably greater than was believed to be the case prior to Hurricane Andrew, (3) A generally held belief that hurricane activity (frequency and intensity) occurs in multi-decadal cycles and that we are in the early phase of an upward trend. This belief, coupled with the apparent belief by some that global warming contributes to this phenomenon, seems to be driving the expectations of reinsurance. Reinsurers are currently charging as much as ten times risk, depending on the layer of coverage. This means that if you start with the average expected annual loss—based on hurricane models used by the market—some reinsurers are charging ten times that amount to cover a single year, depending on the layer that is being covered. By OIR regulation, a direct writer is restricted to premiums that bear a much closer relationship to the layer of risk being absorbed, (4) Creation of Florida "pups." By creating separate corporations limited to Florida homeowner policies, national companies have removed a large amount of the capital that would otherwise be available through direct writers. Risk that had previously been absorbed by direct writers on a national basis is now being covered by reinsurance purchased either at arm's length or from the parent company. In other words, layers that previously had been regulated as direct writing are now being priced as reinsurance, (5) Direct writing companies that seem to be taking advantage of the general public perception and seek rate increases that far exceed actuarially sound rates, and (6) Expenses that currently are tied as a percentage to the premium level, but that do not actually bear any significant relationship to the premium.

Newton: For many years, Florida grew rapidly. There were few hurricanes. Insurance companies eagerly sold policies in coastal areas with larger homes. After Andrew, insurers realized they were exposed to too much risk, and so they raised rates and canceled policies. The state got in the insurance business by creating the Catastrophe Fund and Citizens Property Insurance. These amounted to subsidizing insurance and taking on the worst customers. The state did this to keep the growth and development engine that drives Florida's economy going. Now, with more storms, insurers have models that say the risk is even higher and they want more. That has caused a crisis because it is having an effect on the economy. Development and growth are slowing.

2. What do you think the best solutions are for this crisis?

Newton: FCAN proposed a two part solution. First, we have to make sure the rates are justified. That means thoroughly analyzing rate increase requests and having an independent consumer advocate to challenge rate requests. Second, we have to lower our risk. Insurance merely quantifies our risk. Insurers agree to pay our losses, if needed, so we don't have to save up, and they charge us for it. If we are satisfied the rates we're being charged are okay, then the only other place to go is the risk. We have to lower our risk. That means building codes, but it should also mean taking risk into account with land use planning and growth management. Risk is not considered when financing affordable housing, but it should be. And if homes or buildings are destroyed, should they be rebuilt in the same place? With the funds we are investing through public subsidy of insurance, we need to get something out of it, namely lower risks, so we have lower costs in the future. Reducing global warming, which may make storms worse, should also be considered.

Boggio: The long term solution is building, and rebuilding, EVERYTHING to withstand hurricane winds in Florida, the Gulf Coast, and Southeast Atlantic States. That's a 20, 30, 40 year fix, and will be horribly expensive and politically unpopular.

The short-term answer is for the State to accept the reality that windstorm is currently AN UNINSURABLE RISK IN FLORIDA. The potential for catastrophic loss is too great, and no premium that is even marginally feasible can cover it. Insurance companies don't insure for floods anywhere in the US, earthquakes in California, or war, terrorist attack, or civil insurrection ANYWHERE… and now windstorm damage in the Southeast, particularly Florida. The State will either step in to be the reinsurer, or our construction and growth based economy will collapse. All of us will soon be subsidizing windstorm insurance, in one form or another. We can choose between higher taxes, higher fees, higher premiums, or recession … or some combination thereof.

Burgess: Since the fundamental problem is that the demand exceeds the supply of capital available to cover potential hurricane losses, the solutions must decrease demand and increase supply. There are a number of areas which might provide an improvement to our current situation. I believe two promising areas to address are:

(1) In order to displace as much of the exorbitant private reinsurance as possible modify the Florida Catastrophe Fund (CAT) in the following ways [by] (a) substantially expanding the layers of coverage both above and below the current levels, (b) allowing the CAT fund to charge rates for additional levels that are higher than the pure risk level, but lower than the market levels, and (c) expanding the percentage of primary carrier participation from the current 10% level.

(2) (a) Continue and expand the current efforts to retrofit the existing housing stock to better withstand hurricanes, (b) Remove exemptions to the building code that are creating a whole new generation of houses to be built that we will later be looking at to retrofit to higher standards and, (c) Seriously examine our current property development policies that continue to add to our demand on a daily basis.

Miller: Every conceivable idea is being looked at to build on the very important package passed by the legislature this spring, that included a commitment to hurricane loss mitigation that no state has undertaken before, plus reforms to reduce deficits and assessments from citizens.

Continued on page 18

The Florida Hurricane Catastrophe Fund provides $15 billion in reinsurance to the residential insurance system after the companies meet a $5.4 billion deductible as costs of six or seven cents for each dollar of reinsurance coverage. Private reinsurance costs were 30 to 40 cents on the dollar until April 2008. They are as much as 70 and 80 cents for each dollar of coverage now. If the CAT fund coverage is expanded, probably by lowering the deductible by half, to around $3 billion, there will be an immediate reduction in company's private reinsurance costs for 2007 and rates can go down. CFO Gallagher has estimated there could be a 20 percent rate reduction. This is likely to occur, the CAT Fund fix, in a special session late this year.

The down side is that it becomes more likely the CAT fund will have to sell billions in bonds, which will be retired by a surcharge, maybe three to six percent, on all property insurance, including homeowners, commercial and auto, for 20 to 30 years. *Nothing is free.*

One of the best things that can happen to Florida is a year without major hurricane losses. We are almost through the heart of the hurricane season and nothing bad has happened--the first time in three years we have not had four major landfalls-- but never say never. After a couple of years without major losses, private reinsurance rates and construction costs will come down, Citizens, the CAT fund [and private insurance companies] will have time to build at least some cash reserves.

Pisula: For years the insurance industry has worked to raise the awareness of safety by supporting stronger building codes, retrofitting of older homes, and strong community efforts to better protect our residents. This needs to be taken seriously by all builders and home owners. When a category 1 hurricane goes through Broward County and causes hundreds of millions of dollars in damage, it shows that homeowners are not serious about protecting their most expensive possessions.

There are proposals to permit insurance companies to create less expensive policies, such as covering the structure only and not contents, or offering a policy for the depreciated actual cash value only on the roofing damage. We also need to look to the mortgage industry for relief since they are the ones that require insurance on homes, not the insurance companies.

The CAT Fund is able to offer reinsurance to insurance companies. The fund should be expanded to permit greater levels of reinsurance availability. In years when there were few hurricanes, like this year, this would permit the CAT fund to grow even faster and create even larger reserves for busy hurricane years.

3. What potential solutions have you heard about that you think don't make any sense, and why?

Boggio: Blaming insurance companies is just dumb. They exist only if they can charge more than they pay out in losses over time. They do not exist to help us, or make our dreams come true. We are not in good hands, and we can't count on them, except to try and minimize claims and maximize premiums.

If we regulate them out of profitability, they will simply move on to greener pastures…as they should. We can't demand that the OTHER GUY lose his shirt so we can have what we want.

Pisula: Supporting greater government intervention does not encourage companies to come to Florida. Using a Citizens (CPIC) type government run insurance company to cover all the homeowners is a recipe for disaster. CPIC is already 20 percent of the market, the largest insurer in Florida, and they are so far in debt that everyone else has to bail them out. Our rates will not go down until our buildings are built to withstand minimal level hurricanes, or hurricanes stop hitting our state!

Newton: Deregulation makes no sense. Insurers and some legislators have said the insurance industry is overregulated. That's nonsense. The industry is, by its nature, a regulated industry. Why? Policies are too complicated for the average consumer so we regulate what's in the policy to make sure consumers are protected. We also know that if the policy is inadequate, the rest of us may end up paying through charity or taxes. Another reason for regulation is the insurance industry's exemption from anti-trust laws. Insurers can legally share information about rates and can collude on rates. There is little or no competition in Florida, so there is no incentive to lower rates. Regulation holds insurers accountable. Experiments with deregulation have ended badly, and we don't want Allstate Floridian to turn into the next Enron.

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