Office of Superintendent of Schools
Board Meeting of February 16, 2005

February 2, 2005

Office of Human Resources
Paul M. Cholak, Chief Personnel Officer

SUBJECT: RENEWAL OF BOARD'S PROPERTY INSURANCE PROGRAM

COMMITTEE: INNOVATION, EFFICIENCY & GOVERNMENTAL RELATIONS

Pursuant to the provisions of Section 1001.42(9)(b)(8)(d), Florida Statutes, which provides the requirements that the Board must carry insurance on every school building, in all school plants, including contents, boilers and machinery, except buildings of three classrooms or less, the Board took action on May 19, 2004 to confirm the final placement of its current, catastrophic, all risk, replacement cost property insurance program. The authorization included the confirmation of the purchase of $700 million of coverage with annual premiums of $21,508,236, which reflected at 40% increase of coverage limits from $500 million; a 25% decrease in the windstorm deductible from 4% of values per location to 3% of values per location; and a 16% increase in limits of coverage for broadcasting equipment associated with WLRN, with virtually no increase of premiums from the previous year. Additional authorization was provided for establishment of the Board's budget for flood coverage through the National Flood Insurance Program (NFIP) for properties required to be covered by NFIP coverage, as well as ancillary authorization for expenditures relating to contracting for needed elevation certificates, etc.

The item also authorized the Superintendent, through Arthur J Gallagher & Co. to continue meetings with current and prospective property insurers to further negotiations for a multi-year policy commitment, subject to appropriate cancellation provisions and annual re-rate provisions, for coverage beginning May 1, 2005, or sooner if possible. This confirmation was provided following the Board's authorization to secure and bind coverage, not to exceed $700 million, with annual premiums not to exceed $22 million, which was provided at the Board meeting of April 14, 2004.

These authorizations are permitted pursuant to the provisions of State Board Rule 6A-1.012, which provides authorization for a district school board when purchasing insurance, entering into risk management programs, or contracting with third party administrators, to make such acquisitions through the bid process, or by direct negotiations and contract. The Office of Risk and Benefits Management has developed strategic plans to recommend to the Board when marketing of specific insurance products may be in the Board's best interest, in order to take full advantage of the marketplace. Conversely, the State Board Rule provides needed latitude to the Board allowing for the Board to enter into renewal negotiations for insurance products where the Board would not benefit, and in fact may lose coverages, by seeking competitive proposals.

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As has been standard practice, the requested letter from the State of Florida, Department of Financial Services, was received this past fall, outlining the State of Florida' acknowledgement that the Board, through its broker, Arthur J. Gallagher & Co., were successful in significantly increasing the insured limits, as well as reducing the windstorm deductible without an increase in the premiums. This letter is crucial as pursuant to the provisions of Section 406 of the Federal Stafford Act, the individual state's insurance commissioner must certify that the property insurance carried by an insured is "reasonable" based upon marketplace conditions, in order for a property owner to seek funding from FEMA in the event of an emergency.

Since Hurricane Andrew, at which time the Board incurred an insurable loss of $96 million, and received additional funding from FEMA for various items, the availability of appropriate property insurance coverage providing coverage for all Board owned facilities, furniture, fixtures, equipment, as well as physical damage coverage for the Board's fleet of vehicles, has become a challenge. The two domestic insurance carriers providing coverage to the Board at the time of Hurricane Andrew cancelled their policies following the storm. Since that time, the domestic insurance market has not been able to provide the needed capacity to fulfill the Board's statutory obligations of procuring adequate coverage for its insurable values which for 2005 now exceed $5 billion. Subsequent to the terrorist attacks of September 11, 2001, the insurance marketplace suffered a huge setback, which has further exacerbated an already precarious situation.

As part of a well planned strategy to insulate the Board from these insurance marketplace changes, representatives from the Board's Office of Risk and Benefits Management continually meet with property underwriters representing both domestic and international carriers who participate in the Board's program. This strategy is crucial to the success of the Board's program because underwriters make decisions on who to insure, and on what terms, in many instances based upon not only a thorough review of the risk, but also upon their relationships with clients, and their impression of how familiar the client is with their own risk

Presently, the Board enjoys a very good reputation in the insurance marketplace for two major reasons. First, it has been a very stable insured, and secondly, the Board's facilities are among the best risks to insure in catastrophe-prone areas because of the stringent construction standards, and the fact that the schools are utilized as hurricane shelters. The recent initiatives from the Office of Risk and Benefits Management in receiving FEMA grants to shutter shelter facilities, and other Board-owned buildings, have been looked at positively as well.

STATE OF THE PROPERTY INSURANCE MARKET

The property insurance market consistently improved throughout the first half of 2004, which was reflected in the very good terms of the most recent renewal, effective May 1, 2004. While there was no expectation of significant "softening" which would allow for ongoing premium reductions, it was anticipated that the market would sustain an increase in available capacity, especially in catastrophic-prone areas such as South Florida. Additionally, it was expected that terms and conditions, such as the windstorm deductible reduction of last year, could be continually reviewed and modified in the Board's interest.

The 2004 hurricane season with its series of storms including Charley, Frances Ivan, and Jeanne has reversed the market trend which was on course prior to August, 2004. According to Florida Trend Magazine, the observation was that while it won't be "Andrew-esque", the insurance fallout from these hurricanes will dominate the market this year. The industry blew through its reserves and then some to cover the $17.5 billion in insured windstorm losses in Florida. Mr. Robert Hartwig, Chief Economist for the Insurance Information Institute reported that Florida won't see the same drop in commercial premiums the nation will see, but did feel that there would still be enough capacity to provide adequate coverage. This may or may not be true in the case of the Board where it has all $5 billion of insurable values in a confined area and the risk is solely written as a catastrophic risk.

The driving force within the insurance industry for this coming year will be the status of the reinsurance market. All primary insurance companies purchase "excess" coverage or reinsurance to cover a portion of the risk they underwrite. As it was after Hurricane Andrew and the terrorist attacks of September 11, 2001, the reinsurance companies bore significant losses as a result of the 2004 hurricanes. Many of the reinsurance contracts do not renew until July 1, 2005, which is good for the Board's renewal of May 1, 2005. As such, staff feels that it is important to attempt to obtain some additional limits of coverage, and seek other modifications including the addition of an annual aggregate (maximum) for windstorm deductibles, because these changes may not be able to be made after the reinsurance renewals of July 1, 2005.

RENEWAL PROGRAM OUTLINE

The Board's success in being able to insulate itself from the drastic market changes which have occurred over the past several years is based upon the long term business relationships it has fostered worldwide with insurers and reinsurers. While the Board experienced significant premium increases and loss of available limits following the terrorist attacks of September 11, 2001, the impact was much less than what many other property owners experienced who did not have these relationships in place. It is anticipated that the same will hold true for the Board following the catastrophic hurricane season which has just passed. The combination results in a comprehensive strategic plan to market the Board's program to take full advantage of when the insurance market improves, while limiting the impact to the program when the market deteriorates.

To effectively market the Board's program for the upcoming May 1, 2005 renewal, staff re-evaluated the basis on which the Board's property total insured values (TIV) are determined for insurance purposes. Since land value is not taken into consideration for insurance purposes, the buildings are valued utilizing an average replacement cost of construction on a per square foot basis, which is then merged with the State of Florida Inventory of School House (FISH) reports. For 2005, the Board's TIV's have increased by 10.29% to $5,445,130,413, including the WLRN equipment which includes its antennae and towers, with replacement values of $12,315,000. Because this increase in values reflects as an increase in the carrier's exposures, it is anticipated that the Board's premium will increase, not because of a rate increase, but because the premium is based upon a rate in coordination with total insured values.

Coverage for full TIV limits is not commercially available from a capacity perspective, and is virtually unaffordable. To determine the amount of coverage that the Board should purchase, based upon its values, the insurance industry has adopted three major models used industry-wide, which when utilized; attempt to determine what the district's property loss would be in the event of another major hurricane. This process is known as determining the Probable Maximum Loss (PML). Projections are made utilizing statistics of prior losses and computer modeling of storms. Last year, most models were updated to better reflect updated projections, partly because Hurricane Andrew was re-categorized by the Florida Hurricane Commission to a CAT 5 up from its previous category of CAT 4. This year's models are expected to change significantly following this year's robust and somewhat bizarre hurricane season, resulting in increased loss estimates or PML's.

Upon reviewing early models, and taking into consideration the relationship between the Board's property insurance program, and the lease requirements of the Board's Certificate of Participation (COP) funded properties, which have specific requirements for the insurance which covers COP-funded properties, it is entirely possible that the current $700 million policy limits now carried by the Board should be increased to adequately cover the Board's PML. While this may not be possible, due to market conditions, staff feels that it is important to attempt to secure these higher limits, if available, while taking into consideration the cost of doing so, in conjunction with retaining the aggressive terms and conditions which were negotiated at least year's renewal. The specific wording in the COP lease agreement determines the amount of coverage the Board should seek, however, it does provide the caveat that the coverage must be reasonably and commercially available.

Staff and the Board's broker have structured a recommended renewal program which will be marketed to current and prospective insurers, which includes the following components:

- **INCREASE OF PROPERTY INSURANCE LIMITS FROM $700 MILLION TO A MAXIMUM OF $850 MILLION**

- **RESIST ANY ATTEMPT TO INCREASE THE WINDSTORM DEDUCTIBLE FROM THE CURRENT 3% OF VALUES PER LOCATION, SUBJECT TO A MINIMUM WINDSTORM DEDUCTIBLE OF $1 MILLION**

- **INSTITUTE AN ANNUAL AGGREGATE FOR WINDSTORM DEDUCTIBLES**

- **INCREASE SUBLIMIT OF INCREASED COST OF CONSTRUCTION FROM $30 MILLION PER OCCURRENCE TO $50 MILLION PER OCCURRENCE**

- **ATTEMPT TO KEEP THE COST OF THE CURRENT $700 MILLION PROGRAM, CURRENTLY COSTING $21,508,237, INCLUDING THE BOARD'S STAND ALONE TERRORISM COVERAGE AND WINDSTORM COVERAGE FOR WLRN TOWERS AND EQUIPMENT, FROM RISING ANY HIGHER THAN $24,500,000, TAKING INTO CONSIDERATION THE INCREASE IN INSURED VALUES, AND, IF POSSIBLE, OBTAINING THE ADDITIONAL $150 MILLION IN LIMITS, RESULTING IN A PROGRAM TOTAL OF $850 MILLION.**

The placement of coverage and negotiations with multiple markets is continuing. Meeting with some domestic underwriters in Atlanta occurred in late January, and other meetings with domestic underwriters in Chicago, and possibly New York, are planned. The process which has been in place since Hurricane Andrew includes the Board providing authorization to secure and bind the most coverage possible, up to sought limits, effective the renewal date of May 1, 2005, subject to a maximum annual premium expenditure. An agenda item will then be brought to the Board at the Board meeting of May 18, 2005, to provide the Board with a confirmation of what has been secured and bound, with specifics of coverage, terms, conditions and final premium costs. This structure provides maximum time prior to May 1, 2005, to obtain carrier commitments for coverage, which will be even more crucial this year, based upon the state of the market.

Because the Board also has a number of buildings which are required to be covered by the National Flood Insurance Program (NFIP), many of which have a May 1, 2005 renewal date, staff is also recommending that authorization be sought to establish the 2005-2006 flood budget of $3,500,000, so that premiums due May 1, 2005, can be paid without having any interruption in coverage.

With this year's hurricane season being so severe, it is more important than ever for the Board to be represented before the major carriers. In addition to meeting with domestic underwriters, it is being recommended that the Board' Risk and Benefits Officer be allowed to travel to London the week of February 27, 2005, to meet with underwriters from Lloyd's and other London-based carriers, which currently comprise approximately 45% of the $700 million of limits now carried by the Board. These meetings which have occurred annually for a number of years have proven vital to the success of obtaining needed coverages, from financially strong markets, with attractive terms and conditions.

School Board Rule 6Gx13- 4C-1.07, Travel Expenses – School Board Members, Superintendent of Schools, Employees, And Other Authorized Representatives, requires that out of county travel estimated to exceed $2,500 must be approved by the Superintendent and the Board before travel commences if reimbursement is expected for the full amount. While the cost of trips in prior years has been under that threshold, due to the significant reduction in the value of the dollar against the British Pound Sterling, it is anticipated that the cost of the trip, including airfare and hotel accommodations will exceed that threshold. Therefore, the Board is being asked to provide authorization for out of county travel which will exceed $2,500, however, the final cost of the travel will be subject to the Travel Expenses Board Rule, and the funds are currently budgeted in the Office of Risk and Benefit Management's travel budget.

RECOMMENDED: That The School Board of Miami-Dade County, Florida:

1. authorize Arthur J. Gallagher & Co., Florida to secure and bind maximum available limits of all risk, replacement cost property insurance coverage, not to exceed $850 million, with annual premiums not to exceed $24.5 million, effective May 1, 2005, with payment to be funded from its property insurance budget, with a full report including confirmation of coverages, carriers, deductibles, costs, terms, and recommendations for other property coverages, including broadcasting equipment and towers/antennae for WLRN and coverage for domestic and foreign terrorism, to be submitted to the Board at its meeting of May 18, 2005;

2. authorize renewal of flood insurance with the National Flood Insurance Program (NFIP), through Arthur J. Gallagher & Co., Florida for all properties required by the Federal government to be covered, with estimated premiums not to exceed $3.5 million for coverages effective May 1, 2005 to May 1, 2006; and

3. authorize the Board's Risk and Benefits Officer to be reimbursed for out of county travel expenses, pursuant to Board Rule 6Gx13 4C-1.07, Travel Expenses – School Board Members, Superintendent of Schools, Employees, and Other Authorized Personnel, for expenses anticipated to be in excess of $2,500 to attend renewal meeting with underwriters from Lloyd's of London, and other London companies, with such expenditures to come from the Office of Risk and Benefits Management's travel budget.

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