Office of Superintendent of Schools
Board Meeting of February 15, 2006

February 1, 2006

Business Operations
Ofelia San Pedro, Deputy Superintendent

SUBJECT: **RENEWAL OF DISTRICT'S PROPERTY INSURANCE PROGRAM**

COMMITTEE: **INNOVATION, EFFICIENCY & GOVERNMENTAL RELATIONS**

The School Board is required to carry property insurance on all school buildings, and all school plants, including contents, boilers and machinery, except buildings of three classrooms or less, pursuant to the provisions of Section 1001.42(9)(b)(8)(d), Florida Statutes.

At the Board meeting of May 18, 2005, authorization was received to purchase of a program consisting of $700 million in coverage limits. We ultimately were able to purchase $626,750,000 of coverage from various markets, resulting in the District coinsuring $73,250,000 of the $700 million program.

Total cost of the program for the period May 1, 2005 – 2006 was $23,613,823.76. The original authorization received from the Board at the February, 2005 Board meeting was an amount not to exceed $24 million.

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.

A letter of reasonableness from the Florida Office of Insurance Regulation for the current property insurance program was received this past fall, outlining the State of Florida's acknowledgement that the district's property insurance program as currently structured appears to be reasonable and competitive given the state of the Florida insurance marketplace in 2004 and 2005. 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.

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Since Hurricane Andrew securing appropriate amounts of property insurance coverage has been a challenge. The two domestic insurance carriers providing coverage to the district at the time of Hurricane Andrew cancelled their policies following the storm. The terrorist attacks of September 11, 2001 further exacerbated an already precarious situation. Since that time, the domestic insurance market has not been able to provide the needed capacity to fulfill the district's need to procure adequate coverage for its insurable values which for 2006 now exceed $6.8 billion, an increase of approximately 26% from the previous year.

As part of a strategy to mitigate the impact of insurance marketplace changes, the Office of Risk and Benefits Management continually meet with property underwriters representing both domestic and international carriers who participate in the district's program. This strategy is crucial to the success of the district's program because underwriters make decisions on who to insure, and on what terms, in many instances based upon both a thorough review of the risk, their relationships with clients, and their impression of how familiar the client is with its own risk.

Presently, the district enjoys a very good reputation in the insurance marketplace for two major reasons. First, it has been a very stable insured. The district has not jumped in and out of the market, but have stayed with carriers willing to stay with the district. Second, the district'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 ongoing 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 by existing and prospective carriers.

STATE OF THE PROPERTY INSURANCE MARKET

The defining event facing insurers and reinsurers this renewal season was the storms of 2005. These storms had highly divergent impacts on January 1, 2006 reinsurance renewals, resulting in major price changes for primary property and marine programs, but minimal effect on casualty and accident and health lines.

Total insured catastrophic losses for 2005 are estimated to be approximately $54 billion. This is the largest loss in the insurance industry's history, more than double the size of 1992, the year of Hurricane Andrew. The insured losses from the three major hurricanes of 2005, Katrina, Rita, and Wilma are currently estimated by Property Claims Service (PCS) at $48.9 billion, representing 90% of the total loss for the year.

According to industry studies, the effect of such large losses on the primary insurance industry was mitigated by two major factors. First, the global reinsurance industry is estimated to have borne about 50% of the loss. The second factor was the relative prosperity of the industry at the times the storm struck. Absent the storms, the primary industry was headed toward record territory for profitability.

For the first time since 1978, 2004 and 2005 will be the first years of underwriting profits for the U.S. insurance industry. Not all insurers faired so well. Property insurers with heavy exposures in the Southeast, many which participate in the district's program, suffered horrendous losses, and in some cases went out of business.

A major event of 2005 that impacted both property and casualty insurance was the renewal of the Terrorism Risk and Insurance Act (TRIA) of 2002. This Federal Terrorism backstop averted a possible availability crisis in property and workers' compensation lines, particularly for urban areas such as South Florida.

ASSESSMENT FROM CITIZENS PROPERTY INSURANCE CORPORATION

Citizens Property Insurance Corporation (Citizens), the state-sponsored insurer of last resort created to cover homeowners who cannot obtain insurance from private companies, has announced its assessment stemming from losses during the 2004 Hurricane Season. The assessment will be levied against all policy holders in the state, regardless of which company insures them. The assessment of 6.8% is intended to cover Cititzens' $500 million shortfall from 2004.

At this point, public entities that purchase property insurance are being informed that they will be subject to the same surcharge as other policyholders. This has created quite a bit of controversy. As it stands, the district's portion of the surcharge for 2004, which would be added to its renewal property premiums would be $1,605,740. This premium would be in addition to expected rate increases for 2006.

M-DCPS LOSSES FROM KATRINA, RITA AND WILMA

The bulk of the claims resulting from the three storms which impacted Miami-Dade County Public Schools will be submitted to the Federal Emergency Management Agency (FEMA). This is due to the structure of the district's property insurance program which currently includes a deductible of 3% of the building values per location, per occurrence. While there was damage to a number of facilities as a result of Wilma, damage where the costs of repair will exceed 3% of the value of the individual property was limited to 4-5 locations.

Insured recoveries from Wilma are expected to be approximately $2 million, while the FEMA claims will probably be in excess of $30 million, including reimbursement for emergency payroll expenses, insurance deductibles, food spoilage, and debris removal. This scenario underscores the fact that the district's property insurance program, as currently structured, is more in actually to a catastrophe loss policy, designed to provide protection in the event of a Category 3, 4 or 5 storm.

The district's ability to seek reimbursement from FEMA for damages and expenses is directly attributable to two major strategies including:

- Purchase of excess property insurance coverage which is commercially available in the marketplace, and

- Receipt of confirmation that the district's property insurance program is reasonable based upon marketplace conditions.

In an attempt to save money, over the past few years, some public entities structured their property insurance program to include large layers of self-insurance, where there was no coverage whatsoever. This is not a strategy in which district staff felt comfortable, due to the fact that FEMA could view those layers as an elective self insured layer, and not offer reimbursement for losses within those layers. Very recently, FEMA has informed at least one entity which elected to self insure large layers, as opposed to purchasing commercial insurance which was commercially available, that there would not be reimbursement for losses within the self insured layers.

M-DCPS' approach on the other hand has been to remain a consistent force in the property insurance marketplace, continuing to improve its risk through the receipt of FEMA mitigation grants to shutter existing facilities. The district's current 5-Year capital plan, which includes the elimination of portable classrooms, has been viewed very favorably in the insurance marketplace. Because of the district's very good reputation in the marketplace, staff believes the limited capacity in a very difficult year will be made available first to customers like M-DCPS.

RENEWAL PROGRAM OUTLINE

To effectively market the district's program for the upcoming May 1, 2006 renewal, staff re-evaluated the basis on which the district'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 2006, the district's TIV's have increased by approximately 26% to $6,844,798,724. Because this increase in values reflects an increase in the carrier's exposures, it is anticipated that part of the district's premium increase will be as a result of the increased insured values. It is also expected that the layers which make up the district's coverage in excess of the first $50 million layer will experience premium increases due to the re-modeling of wind storms by insurers to reflect increased severity and frequency reflecting recent actual experience.

Based on the current view of the market, coverage for full TIV limits will not be commercially available this year, and even if it were available it would be virtually unaffordable. To determine the amount of coverage that the district should purchase, based upon its insured values, the insurance industry has adopted three major models 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 revised 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 and as a result of the multiple storms in 2004. As stated earlier, it is expected that this year's models are expected to change significantly following 2005's hurricane season, resulting in increased PML's. In some instances modeling will be based on an expected two storm model, which will prevent some insurers from continuing to participate in the district's program because of their reinsurance treaties.

As a result of increased PML's and constrictions in available capacity, staff does not expect to be able to renew to the current $700 million policy limits.. There is an important relationship however between our insurance program and the lease requirements in the Certificates of Participation (COP's) used to finance the district's capital plan.

The district's property insurance is specifically endorsed to have insurance proceeds pay for those COP-funded facilities before any other district-owned facility, pursuant to the lease requirements. As such, it is crucial that the limits carried be adequate to cover anticipated damages from storms for all facilities. The specific wording in the COP lease agreement determines the amount of coverage the district should seek; however, it does provide the caveat that the coverage must be reasonable and commercially available.

Staff from the Office of Risk and Benefits Management, the district's broker and participating intermediaries, has structured a recommended renewal program which will be marketed to current and prospective insurers, including the following components:

- Attempt to renew a program which maximizes the available limits of coverage with a goal to obtain limits of at least $350 million. The current program consists of 10 layers with $700 million in coverage, with some district participation as a coinsurer in the top three layers. Multiple carriers, including Allianz Insurance Company which currently provides $35 million in capacity, have provided non-renewal notices. Achieving the $350 million at renewal will be difficult.

- 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 unless there are considerable premium reductions for assuming additional risk

- Strategic pricing of available layers of coverage to retain insurers who are currently providing coverage and attract new markets. In order to accomplish this, in light of the difficult market and the district's 26% increase in total insured values (TIV) to $6.8 billion, authority to purchase maximum available limits with premiums not to exceed $30 million is requested, which includes assessments from Citizens.

Renewal discussions have begun with multiple markets, both domestic and international. Meetings were held with many domestic underwriters in the Atlanta area earlier this month. Additional meetings will be held with other domestic markets. London based markets, however, including Lloyd's of London, and other European markets will also be visited as Lloyd's provides the largest percentage of coverage on the program.

The renewal process which has been in place since Hurricane Andrew includes the Board providing authorization to secure and bind the most coverage available, up to sought limits, effective the renewal date of May 1, 2006, subject to a maximum annual premium expenditure. An agenda item will then be brought to the Board at the meeting of May 10, 2006 to provide 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 the property program's renewal date of May 1, 2006 to obtain carrier commitments for coverage which will be even more crucial this year based upon the state of the market.

Because the district 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, 2006 renewal date, staff is also recommending that authorization be sought to establish the 2006-2007 flood budget of $3,500,000 so that premiums due May 1, 2006 can be paid without having any interruption in coverage.

With last year's hurricane season being so severe, it is more important than ever for the district to be represented before the major carriers. The district's Risk and Benefits Officer has annually traveled to London to meet with underwriters from multiple syndicates from Lloyd's of London and other London-based carriers. Last year two major reinsurance companies expressed an interest in participating in the program. Swiss Re and Munich Re, two of the world's largest reinsurance companies provided some small capacity, however they have expressed an interest in providing additional capacity for this year's renewal. Therefore, during the week of March 18, 2006, the Risk and Benefits Officer will be traveling to London to meet with markets for three days, then meet with senior underwriters with Swiss Re in Zurich for one day, and then with senior underwriters with Munich Re in Munich for one day. These meetings are crucial for purposes of marketing the district's program to existing and prospective markets including negotiating premiums, terms and conditions of the contracts.

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. The Board authorized travel last year due to the significant reduction in the value of the dollar against the British Pound Sterling which resulted in the cost of the trip exceeding the $2,500 threshold. This year, with additional meetings in Zurich and Munich, it is anticipated that the cost of the trip including airfare and hotel accommodations will again 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 staff, through Arthur J. Gallagher & Co., Florida to secure and bind maximum available limits of all risk, replacement cost property insurance coverage in anticipation of obtaining at least $350 million with annual premiums not to exceed $30 million, effective May 1, 2006, with payment to be funded from the district's 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, submitted to the Board at its meeting of May 10, 2006;

2. authorize renewal of flood insurance coverage 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, 2006 to May 1, 2007; and

3. authorize the district'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, Swiss Re, and Munich Re, with such expenditures to be funded from the Office of Risk and Benefits Management's travel budget.

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