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Florida Property Insurance Reform Version 2011

Bad Timing Given the Symbiotic Relationship of Property Insurance, Real Estate, and the Bad Economy

The Tampa Bay Business Journal recently reported that "nearly half of Tampa Bay area homes are underwater (48.1%) at the end of the first quarter." Miami, Orlando, Jacksonville, and Ft. Lauderdale reportedly were very close to the same percentages. Times change, markets correct, and as night follows the day, abuses in business, overheated markets and bad conduct are often examined by our elected officials and compensated for in the form of new legislation. Nothing wrong with that, but sometimes things get too far out-of-hand and the consumer ends up damaged by the process.

Take for example the property insurance legislation in Senate Bill 408 signed into law by Governor Scott. While widely heralded as needed property insurance reform, this legislation over reached and will likely have far reaching and damaging consequences for consumers if our luck runs out and the BIG ONE makes land fall in any metros with high negative real estate equity. Let me explain.

The insurance industry chiefs and their lobbyists made two main claims to advance their agenda for so called "property insurance reform," both (according to them)

necessary for our well being.

First, insurers said they needed to raise rates. The rationale is that if rates are allowed to increase, more companies will flock to Florida, compete for business and push rates down given the additional competition. This would result in cheaper long-term insurance premiums and more financially solvent insurance companies. Raising rates would also help speed an end to Citizens Insurance, which is questionable logic given its strong financial rating and surplus capital.

In my mind this proposition is as speculative as an overheated housing market. Property rates seldom drop once they have been raised and I doubt they will, given the newly released updated hurricane risk models. If you haven't noticed, double digit premium increases are routinely being approved in rate filings. And to add injury to insult, there is a provision for re-insurance costs that will be passed on to the consumer. So will raising rates on property insurance be beneficial to the policyholder? I think most of us know who will benefit from raising rates. I am just not sure the powers to be fully understand the consequences of this piling on in our current economic state. As an aside, it would be interesting to know if raising insurance rates on underwater property owners in a high unemployment state like Florida is a moral hazard issue concern to underwriters.

The other legislative agenda was to deal with the "cost drivers" which depending on who was talking included a variety of people, professionals, and issues. Raise rates, cut claim costs (the drivers) and all are in good order ...for the insurance industry that is. And just maybe this scheme would trickle down to benefit consumers.

Let's take a closer look at those "cost drivers." What and who are they? Well, let's start with the big one - the policyholder. When you file a claim, your claim is a cost to the insurance company. How did the legislation address you and the cost drivers associated with your loss? Simply change the way you get paid following a

loss. Now instead of being paid for your full loss, you will be paid a lesser amount commonly known as the "Actual Cash Value" (ACV). This of course assumes you purchased a true replacement cost policy or at least you thought you did!

As background, prior to the 04-05 hurricanes most property policies allowed for paying an ACV amount, but the general public had not read the fine print of their policies. So a huge cry was raised when the adjusters took a "hold back" or depreciation in their statement of loss settlement submissions. This outcry was subsequently heard by the legislators who gave the public what they thought they had purchased; a policy requirement that paid the full amount of the loss. Suddenly a few years later this is now claimed to be a huge "cost driver".

The 2011 legislation aligns admitted and surplus lines carriers in their requirement to pay only the depreciated amount of a loss until the work to restore or replace the property is actually completed. As a consumer advocate, I do not have an issue with a policy provision that clearly states you only get paid the ACV of your loss until you actually do the work. The problem is the timing. Paying someone less than their full loss in the aftermath of a catastrophic event like a hurricane will likely cause chaos to already struggling property owners. The concept of fix your property first and then we will pay the full amount of your loss also shifts the cost burden to many underwater property owners who are in no condition to front additional costs. This looming problem could have simply been addressed in the legislation with language that in case of a major catastrophic event where the governor declares a state of emergency and during the time period of that declaration (which may be one year or more) that policyholders will be paid the full amount of their loss without deduction for depreciation or hold back, provided they actually purchase a replacement cost policy. This just makes good sense to me.

My other concern is this will likely create a very long, disjointed, and argumentative process for people to recover the depreciation that was withheld. I am unaware

of requirements for insurance companies to ramp up competent staffing to deal with the very long adjusting tail of a big CAT event. Imagine all the insured's or their contractors sending in a plethora of receipts for carpet, wallpaper, tile, and a whole host of other items given the difference in quality, quantity, scope of loss issues, and price that is likely to be disputed as the adjustment process slogs on. Requiring actual repair documentation and auditing requests for reimbursement of depreciation holdback may be manageable in a normal day to day claim environment, but it will be chaos for policyholders and carriers alike in a post catastrophic recovery period. Add to the confusion another "cost driver," from this legislation ...the time you have to bring a claim which has been reduced by two years!

The shift in failing to pay an insured the full amount of their loss following a catastrophic event may have another unintended consequence legislators do not grasp. Abandoned homes in neighborhoods impacted by the storm. Policyholders may simply walk away from upside down damaged homes because they need to come up with significant cash to complete the repairs before being audited by the insurance company to verify covered damages at a price the insurance company decides it wants to pay. How many homeowners are going to make repairs on a home that may be worth significantly less than what is owed? If the consumer becomes a "walk away" and the ACV goes to the bank or other lien holders, do you really think these businesses will pay to fix an upside down home? Not likely. Instead the more likely outcome will be for mortgage holders (if it can be determined who legally owns the mortgage) to apply the ACV payment to the outstanding note leaving each neighborhood to deal with the derelict and unrepaired properties that create another short sale to drive down property values.

This legislation also extensively deals with the sinkhole "cost drivers". Not enough space to cover that subject here, but almost daily we read about how real sinkholes affect Floridians' property. Please pay close attention to this coverage. Now is the time to have a personal visit with your insurance agent so you understand what is, or perhaps what isn't covered should your home be

impacted by a sinkhole.

One thing for sure, given this new property insurance legislation, your hurricane survival kit should include a lot of extra cash. If cash is in short supply and if you have any equity left in your property, it may be a good time to start a conversation with a banker or other financial institution about establishing an emergency line of credit to help you bridge the gap between your loss and possible insurance reimbursements.

Remember, you still have big wind deductibles among other limits and exclusions to overcome from an increasingly costly insurance policy. They say timing is everything. Right now you have some time to prepare and empower yourself. Call your insurance agent and educate yourself, your family and business colleagues about the risks and financial exposure you face if the Big One hits your community this year.

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