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Representing:

STATE BOARD OF ADMINISTRATION

DEPARTMENT OF LAW ENFORCEMENT

BOARD OF TRUSTEES, INTERNAL IMPROVEMENT TRUST FUND

The above agencies came to be heard before THE FLORIDA CABINET, Honorable Governor Scott presiding, in the Cabinet Meeting Room, LL-03, The Capitol, Tallahassee, Florida, on Tuesday, November 15, 2011, commencing at 9:05 a.m.

Reported by:
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Chief Financial Officer

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P R O C E E D I N G S

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(Commenced at 9:25 a.m.)

GOVERNOR SCOTT: The first item is a presentation regarding the Florida Hurricane Catastrophe Fund, presented by Jack Nicholson. Good morning.

MR. NICHOLSON: Good morning, Governor and Cabinet. I've been asked to provide you an update of the Florida Hurricane Catastrophe Fund and also to discuss some recommendations. First I'd like to start off providing you some background.

My presentation is organized as follows. I'm going to talk about Florida's hurricane environment, the residential property insurance market, the role and purpose of the Cat Fund and discuss some recent background in terms of history, legislation that has changed the Cat Fund, the current status of the Cat Fund and then some recommendations.

So first let's look at the hurricane environment in Florida. I think it's very important for us not to get hurricane amnesia. It's easy to do. Florida has a landfalling hurricane 6.4 out of every 10 years. It has a Category 3 or greater hurricane once every four years. A Category 3 hurricane is wind speeds of 111 miles an hour and can blow roofs off of buildings.

Let's look since 2005. We've had 86 tropical storms, 40 hurricanes and 17 Category 3 or greater hurricanes, zero landfalling hurricanes in six years. So we've been very fortunate the past six years. I think it's kind of like the state of Florida playing a game of Russian roulette with hurricanes. And all you have to do is look at the maps every year and see what's coming and what's projected and what actually happens. And it is actually a game of Russian roulette with hurricanes.

The second aspect of Florida's hurricane environment is exposure growth. Since the Hurricane Catastrophe Fund was created in 1993, the exposure has grown by a factor of three. Today we have $2.16 trillion of residential property exposed in the state. A lot of that has occurred since 2000, about 2.45 -- a factor of 2.45, almost two and a half percent has occurred since 2000.

And then another factor affecting Florida is the volatility of risk capital. That's private capital, people willing to commit risk to Florida to insure, to reinsure exposure in Florida and that sort of thing. Florida has one of the highest probable maximum losses. The 100-year probable maximum loss for Florida is $55 billion. So that means there's a one percent probability every year of that occurring. It's expected to occur once every hundred years, of course.

But when you compare that with other states, Florida dwarfs any other state. Texas, about 13.4 billion 100-year probable maximum loss; Louisiana, about seven. And the rest of the states along the Atlantic coast, nobody has over $3 billion virtually. So if you accumulated everybody's 100-year probable maximum loss, it would not total to Florida's.

Now, the problem with that is diversification. Florida is the peak zone worldwide for risk, for hurricane risk and for all catastrophic risk. What you would do if you were a reinsurer is you would look some place to diversify. There's a couple of good places I could think of. California. But California doesn't require people to buy earthquake insurance, so it's not quite a match. And you can't really diversify trying to write California risk.

China would be another situation. Eventually, when China starts insuring more property, that would be a logical alternative. But until then, Florida pays a lot for private reinsurance. It's inevitable. Risk capital is expensive.

Also, risk capital is highly volatile in terms of availability and cost. This is no better evident than after Hurricane Andrew in 1993 or after the 2006 -- during 2006, after the '04 and '05 hurricanes here in Florida. We had a high volatility of the price and the availability.

One study that I looked at of ten large reinsurers over a 12-year period, seven of those years there were capacity shortages. Five years there were capacity surpluses. In terms of the overall cost, right after Hurricane Andrew, the price of reinsurance tripled. It came down by about a half by the year 2000, and then it went up double in 2006.

So with the volatility of risk capital, it creates a unique problem for Florida. I want to talk more about that, but let's go to the -- this chart is illustrative of what could happen. And it's just a model, a model -- a modeling firm modeled 250 ways that you could exceed $100 billion losses in Florida. So these are just hurricane tracks and storms. I want to note that 25 of these, the losses would exceed 200 billion. So we're certainly vulnerable to large losses and large events.

The next slide is a discussion of the marketplace in Florida. And this really just is the structure of what we're talking about. The bottom, you see the 2.16 trillion of risk. There's about 6.4 million units of risk insured, about 6.1 million policyholders that that translates into, 171 companies, including Citizens, that participate in the Cat Fund.

It's a mandatory program that everybody has to participate in, if you write residential property insurance. And that includes houses, mobile homes, apartments and condos, as well as the contents of those things. So if you write any of that, you're required to participate in the Cat Fund.

We collect a premium each year of about 1.3 billion. The total residential premium in the state of Florida is about $10 billion. So we collect about 13 percent of the overall premium in the state of Florida to provide Cat Fund coverage. If a company, of course, becomes insolvent, it goes to the Florida Insurance Guaranty Association to bail out those policyholders and that sort of thing.

The next slide is a couple of bullet points here for the discussion of the role of the Florida Hurricane Catastrophe Fund. I mentioned earlier that it was a mandatory program. I'm going to kind of describe the reason for that. In 1993, when the Cat Fund was created, the legislature said, we want it to be tax-exempt.

We want it to be tax-exempt in terms of revenue received so that you don't have to pay taxes. And it is. We were able to obtain a private letter ruling. It amounts to about a $450 million benefit for the State every year because we're able to accumulate funds without having to pay taxes on our premiums.

One of the requirements in the Internal Revenue private letter ruling was the Cat Fund needed to be an integral part of the state. It's where a lot of people miss the whole purpose of the Cat Fund. It is designed to benefit the state of Florida, not insurance companies. It was never the intent to benefit insurance companies directly. It was to benefit Florida and to recognize certain problems that are in Florida.

And I've already alluded to some of those problems with the volatility of risk capital. The concept behind the Cat Fund is to provide a stable and ongoing source of reimbursement to insurance companies, to provide additional capacity in the marketplace. And that was what was missing in 2003 following Hurricane Andrew, and 2004. It's to operate efficiently as a tax-exempt state trust fund, help Florida stabilize its economy from the impact of hurricanes. In that respect, it's a risk management tool for the State to manage hurricane risk.

So from that standpoint, we all benefit. I don't care who you are in the state of Florida, you benefit by having a stable residential property insurance market.

Right after Andrew there were problems with policies being canceled, availability of coverage that threatened the real estate market, the home-building market, the mortgage market and all the ancillary businesses that were associated with that. The whole survival of the economy was at stake. And that's why something had to be done to provide a stabilizing product.

So when I talk about the Cat Fund versus private reinsurance, the main distinction that I draw is the Cat Fund offers a different product. It's a stabilizing product, stable in terms of price, stable in terms of capacity. I'm going to talk more about capacity and how we need to work to make that more stable to be able to do the job that the Cat Fund was intended to do.

Here is the basic structure of the Cat Fund. I'm going to show you a chart in a minute. It's going to be way too complicated, so I want to focus on this one to make sure you understand the basic structure.

The Cat Fund has a deductible that insurance companies absorb before they have any coverage. Then they have a co-pay. That co-pay is generally 90 percent. Most companies, 99.9 percent of all premium in Florida is written by companies that have chosen the 90 percent coverage option. They can choose 75 or a 45 co-pay, but for the most part, they all choose 90 percent.

Cash is accumulated when we don't have storms. We charge premiums. That premium I referred to earlier, the $1.3 billion of premium will be accumulated. If we don't have a storm this year, that will go into our cash balance to pay future losses.

To the extent that the cash is sufficient, we'll pay claims out of that. To the extent that it's not sufficient, the way the Catastrophe Fund works is that we issue revenue bonds funded by what are called emergency assessments. They're broad-based assessments on practically all property, casualty lines of business, excluding workers' comp and medical malpractice.

But it's about a $33 billion assessment base. We can assess up to 6 percent a year, which would be about $2 billion a year, or 10 percent for multiple years for multiple storms. So the assessment of the Cat Fund is limited to 6 percent per year.

That is a number that I think the legislature looked at originally and thought about the risk to the state, said this is how we're going to control it. The Cat Fund is not going to be an obligation of the State. What we're going to commit is a 6 percent assessment. Actually, the first year it was a 2 percent assessment. If the governor found that a state of emergency existed, it could go to four. It was later increased to 6 percent in 1999, and it's been that since.

So, anyway, that's how the Cat Fund is funded, by cash and then emergency assessments through the issuance of a broad-based bonding revenue source.

The next slide mentions some background that's very important. Since 2006, the storms of '04 and '05, there were eight hurricanes, seven that triggered the Cat Fund. We had residential losses that were reported to us of something on the order of $29 billion. Not all losses were reported to us because some companies exceeded that after they got completely paid by the Cat Fund, so I'm not sure what the final total would be. But we paid about a third of those losses over those two years, a little over $9.65 billion or so. So the Cat Fund paid a third of the '04 and '05 losses.

During 2006 there was concern about rates, and rates had spiked because you had this volatility in the private market. Although the Cat Fund provided some stability, it wasn't enough. You had rates go up pretty substantially. The legislature passed Committee Substitute for House Bill 1A in a special session in January of 2007. The idea was to expand the Cat Fund to replace private reinsurance with cheaper Cat Fund coverage, therefore lower rates. So that was done.

Following that, we all remember what happened in the summer, early fall of 2007, the subprime mortgage crisis hit. It had a major impact on the bonding markets and the debt markets and has continued since, actually changing the entire structure of what we were used to seeing and used to dealing with with regard to the issuance of debt. So it adversely affected the Cat Fund's ability to issue revenue bonds. And although we have a very strong revenue source, that was not the problem. The problem was access to capital. I'm going to talk more about that in a moment.

There was some legislation passed in 2009 that actually got rid of a lot of the capacity, or let me say that it phased it out over a period of years. It hasn't completely phased out yet for the optional coverage. The optional coverage was put on top of the Cat Fund. At the time, the Cat Fund was $15.8 billion or so. It's 12 billion on top of the Cat Fund. There was also about 6 billion on the bottom, below the retention. If you look at all the potential coverage that could have been available theoretically, $38 billion, only about 28 was actually purchased, only 28. We were going from 16 to 28.

The situation that we're in today, that coverage has bled off so that the optional coverage on top of the Cat Fund is only 6 billion. But what has happened is companies have understood what has gone on in the capital markets. They've only purchased about a billion dollars of that. So we've actually transferred $11 billion back to the private market since 2009, $11 billion. And we're on a path to phase out that final billion in a couple of years. But it's already -- the markets have accelerated that phase-out much faster than the legislation would have or did.

But what we find today, with the coverage that was purchased in the Cat Fund, we had a limit of 24 billion that was potentially available. Like I said, it wasn't all purchased. So what was purchased was $18.4 billion, roughly. We have a cash balance of about 7.2 billion. That would require about 11.2 billion of bonding.

Just recently, when we did our bonding estimates, which are done twice a year, in May and October, we found that our bonding estimates would only produce about $8 billion of potential debt. That would produce a $3.2 billion shortfall, potential shortfall. I underscore the word "potential" because we haven't had a hurricane, so we don't have a shortfall right now. But if we had a hurricane and had to pay for the coverage that was purchased in the Cat Fund, we would be short by

$3.2 billion.

GOVERNOR SCOTT: Can I ask a question? When they did that -- so this is just your latest estimate of what you could bond, right?

MR. NICHOLSON: Yes, sir.

GOVERNOR SCOTT: When they did that, did they take in consideration if Citizens was trying to bond at the same time?

MR. NICHOLSON: I think so. I think that we -- the problem with the Cat Fund and Citizens, we both have the same assessment base. We have a better credit rating. But the problem is, we are the, quote, unquote, reinsurer for Citizens. So they would have losses, trigger us, we would pay their claims and so forth.

I've analyzed the impact on Citizens. This would be about a billion dollars of their capacity that they would be short of because of this, because they're about a third of the overall capacity of the Cat Fund.

GOVERNOR SCOTT: But it wouldn't impact their ability to bond at the same time?

MR. NICHOLSON: I think it would. I think that there's a timing difference, obviously. But if we're using the same revenue base and we're issuing all the bonds we can at the highest possible interest rate we can bring in the money, both taxable and take-exempt, because we're doing everything we can, I think it would adversely affect Citizens' abilities.

A month or two later could make a difference. A year or two or so could make a big difference, or even six months down the road. So that's really a good question for a financial adviser to weigh in on.

GOVERNOR SCOTT: But your belief is, it wouldn't impact your bonding, it would impact Citizens' bonding. You could get to the 8 billion. It would impact Citizens --

MR. NICHOLSON: Right, right.

ATTORNEY GENERAL BONDI: But it also depends on the market, right, the 8 billion?

MR. NICHOLSON: Well, yes. We're looking at the market in October. This is where this number came from. That's what our underwriters, our four underwriters came up with. That was the average value. It ranged, actually, from 5 to 11 billion. And that's another problem.

Back in May we were looking at 12 billion potential bonding. It ranged from 4 to 23 billion.

So the point I'm making --

GOVERNOR SCOTT: It's just their estimates, right?

MR. NICHOLSON: It's their estimates.

GOVERNOR SCOTT: There's no guarantee. It's not like anybody has to buy.

MR. NICHOLSON: Right. And we don't know what the market is going to be when we actually go to the market. So the actual bonding capacity is what we are obligated to do, and that's what the State is obligated for. But obviously there's a problem when you have large reliance on debt and then you have to come up and estimate in a very volatile market environment. How do you do it?

GOVERNOR SCOTT: So let's step back. You said the State is obligated, or is it the Cat Fund?

MR. NICHOLSON: The State is not obligated. The Cat Fund sells two things. It's cash, and it's whatever bonding it can do based on its assessment authority. That's what we're limited to. So whatever we can do is what we can do for the companies. That's what they get in terms of coverage.

GOVERNOR SCOTT: There's no obligation, though. The State, if something happened, we're not obligated to write a check out of general revenue, right?

MR. NICHOLSON: That's correct. The problem would --

GOVERNOR SCOTT: It's a different issue whether we would have some other reason to do that.

MR. NICHOLSON: Well, yeah. The problem would be if you had insolvencies that are the result of this. I'll talk about that in a moment.

CFO ATWATER: Governor, can I --

GOVERNOR SCOTT: Go ahead.

CFO ATWATER: Jack, on the slide, just two quick questions, and maybe you're going to touch on them later. But on that previous slide, if we make it through the next two to three weeks, four weeks, whatever else, the likelihood of an event occurring, what would be your estimate of the cash balance growing as we approach the season for next year?

GOVERNOR SCOTT: Next June 1st, as an example, for next June 1st.

CFO ATWATER: If we're 7.2 billion here.

MR. NICHOLSON: Approximately 1.3 billion more. So we would be looking at probably 8.4 billion.

CFO ATWATER: Okay. Second question. Given the 3.2 billion in the red on this slide, how does that play out in the private market, when the agencies that rate the quality of those companies are buying into a program that the agency doesn't believe could actually provide all the reinsurance if it was necessary? Are they forced to then go buy a double, go buy someplace else in the marketplace to cover the same gap?

MR. NICHOLSON: They may, because the rating agencies, my understanding is they do give the Cat Fund a haircut, so to speak, in terms of the overall capacity when they look at this, and they understand the volatility of the bond markets and how much capacity we may be headed for.

I believe that when a rating agency -- I don't want to mention names here, but I think they did this even prior to this hurricane season, and they have done that on a regular basis. I could get you the numbers.

GOVERNOR SCOTT: Just to make sure, I think what you're saying, CFO, is that an insurance company that might be reinsured by the Cat Fund might have to buy two different -- might have to buy coverage two different ways, which ultimately gets passed on to the consumer.

CFO ATWATER: Correct. And you think of a private market player doing business in Florida that everything about their rating is important to their ability to attract capital and to be a successful business model, if that rating agency looks at Florida and says, we'd love to give you an A rating but you're in a pool where we don't think you can even get funded, so we're going to have to ding your rating, which then impacts their abilities in the marketplace, or they go double-up and, you're right, pay twice. They go offshore and buy, or wherever, and buy reinsurance. So though they're forced here to play, they also have to go buy somewhere else.

MR. NICHOLSON: Yes, sir, that's exactly correct. And my understanding is that's what they're doing, and that's what the rating agencies are doing.

CFO ATWATER: All right.

GOVERNOR SCOTT: Thank you.

MR. NICHOLSON: So these charts get a little more complicated, so what I'm showing here is the -- the yellow on the top and on the bottom is some of the optional coverage that existed this year. I didn't put any numbers here. I'll do that in the next slide. We also had some pre-event notes that actually we bought in 2007, in October. They expire in 2012. So they're really not something that we can count on for this hurricane season, since we'd have to replace them if we had losses by October. And so you'd have to assure -- be assured that you could do that, and I don't think we can, given the market conditions.

The next chart is the more complicated one, and it has the numbers. But it basically shows you that -- the green, everything in green is the mandatory coverage of 17 billion. The yellow on top is the roughly 1 billion. The .994 is the amount of optional coverage that the -- the 12 billion has come down to 6 this year, but only 1 billion or so was purchased. And then there is some below the Cat Fund that was purchased.

The purple line kind of shows you what we could reach in terms of our overall capacity, 15.14 billion, if there were a loss this year. And that's roughly 17 and a half percent short or 3.2 billion short of overall capacity.

So we can go to the next slide. Now, to discuss a little more about what's going on, we're all familiar with the U.S. financial markets. The federal government has been downgraded. There's concern about balancing the budget going forward.

The world financial markets are in turmoil right now. What's going on in Europe certainly affects the financial markets dramatically.

If you're an investor -- and the Cat Fund is an investor. We have a lot of assets, second under the Florida Retirement System assets, under management with the State Board of Administration. When we talk to our investment people, we have a very conservative investment policy, but when we go through some of the investments, they look at it and say, well, this one is in trouble, we're going to get rid of that or we're not going to buy this anymore or whatever.

You know, you look at that and you say, well, how would people look at the Cat Fund in their portfolio. And you wonder, you know, are they going to be committed to something, the 30-year debt in this environment, and how would we be looked at?

So the financial markets have changed. The municipal market in particular has undergone some dramatic changes. There's no more bond insurance available. Bond insurance was very important in the municipal market because actually it created a commodity product. So one debt was just like another debt because it was AAA, AAA, you know, it didn't matter. The analysts that were buying this stuff, they didn't have to do a lot of research. They bought it like a commodity. That created liquidity and a secondary market for trading.

Once the bond insurance went away, it created a problem for analysts, in that they had to research thousands of investments. They had to understand what these municipal credits were all about. And the market base shrunk dramatically. The number of products that were offered prior to 2007 have shrunk and the investor base has shrunk. That is the heart of our overall problem.

The next slide shows graphically -- now, again, this is a complicated chart, but I want to explain that there are two bars for each year. The first bar is October -- excuse me. There's four bars. We've got October and May, and then the blue bar represents the initial season capacity. The green bar represents what's called subsequent season capacity.

Just to talk about that a moment, because it's very important, after the Cat Fund pays claims, what you don't want to happen is the next year the Cat Fund not to have any capacity because you created an instant crisis, because then you've got to buy all your private reinsurance from -- all your reinsurance from the private market, and the Cat Fund is going to have very little, maybe a premium is all the coverage we could provide, maybe a little bit of bonding. It just depends.

So this became a substantial problem. You can see that once the assessment authority was increased in 1999 -- and that actually wasn't sufficient. It was four percent a year and two percent as a backup, or six in the aggregate. That's how it was provided. That didn't increase to the current six and ten until 1999, or excuse me, until 2004.

But you can see that subsequent season, the green bar kind of built up, and then in 2004 we increased the capacity to 15 billion. There was a limit statutorily on our capacity in 1999 of 11 billion. It went to 15 billion in 2004, and then it shot up, this 12 billion, you know, 28 billion in 2007. So what these bars represent are initial, subsequent and any future capacity. So it's the strength of what we could finance.

And if you look at the last bar, that's all this chart is about, is in October of 2008 we were able to provide only half of the capacity that we sold.

And continue to talk about that, let's look at the last four years. In May 2008 -- these are two bars for each year, but I've got the years circled, 2008, '9, '10 and '11. And in red is the shortfall, potential shortfall, and green is a potential excess. And you can see, in October of '08, we were looking at a $14.5 billion potential shortfall; October of '09, a 4.2 billion potential shortfall.

Then we come back, in rosy times, we estimate a little bit more and we're able to have an excess of about 6.6 billion in 2010, October 2010. That was favorable compared to the May estimate. And then this May we had a 700 million surplus or excess, and then October, 3.2 billion shortfall.

GOVERNOR SCOTT: Jack, this is just assuming that today the market stays the same. We actually don't have any idea. I mean --

MR. NICHOLSON: Exactly.

GOVERNOR SCOTT: -- your bonding capacity could go way down, depending on what happens on world markets.

MR. NICHOLSON: That's correct.

GOVERNOR SCOTT: It's just somebody's guess.

MR. NICHOLSON: That's exactly it, and that's the problem.

GOVERNOR SCOTT: The only thing you know is the cash that's in the bank.

MR. NICHOLSON: Yeah.

GOVERNOR SCOTT: And you better hope you make money on that.

MR. NICHOLSON: The other thing that we do know is this stuff is highly volatile. Anybody that thinks they can estimate it can't. And I would be a liar to you if I stood up here and I could tell you that this had any reliability whatsoever. We are at a very risky position with the Cat Fund today because we're in a situation of selling coverage that doesn't exist and then having companies rely on that coverage come up short at the time of an event, and we have no idea of knowing what the markets are going to be. And we do know the financial markets are highly volatile.

So the next slide kind highlights the legal requirements. And I want to make clear that the idea behind the Cat Fund is to estimate our capacity, so we give the companies information, and we try to give that information twice a year, in May and October, and that's the reason for those two estimates.

But the law says that these estimates are to be used for all regulatory and reinsurance purposes. So we're forcing the insurance companies to use those numbers that we estimate. And if those estimates are off, too bad, because that's what they've purchased their coverage on and that's what they're required by law to use for all regulatory reinsurance purposes.

GOVERNOR SCOTT: And as the CFO just pointed out, if they were so good, they wouldn't change like this at estimating. You go back to the prior slide. Look at the change. It's constantly -- no one knows what's going to happen, except we know there's unbelievable volatility.

MR. NICHOLSON: When you say "if they were so good," who are you talking about?

GOVERNOR SCOTT: These estimators.

MR. NICHOLSON: Oh, you're exactly right. These estimators happen to be --

GOVERNOR SCOTT: You're good. Don't worry.

ATTORNEY GENERAL BONDI: Not you.

MR. NICHOLSON: No, I'm not good. I'm not good. I can make a small fortune, but you've got to give me a large fortune first. But, anyway, the estimators that we're talking about are Goldman Sachs, J.P. Morgan, Citibank and Barclays, the top financial banks in the world. And they have a wide range of difference from time to time among themselves. So nobody can do it. And that's the whole lessen here. Nobody can do it. Nobody can do it reliably. We need to be able to do it reliably. For the Cat Fund to work and stabilize the market, that's an essential requirement.

So we've talked about this. I want to talk about the last point, the potential impact on participating insurers. I think I can go to the next slide, though, because it's really talking about problems. And the first problem is potential insurer insolvencies.

Now, there needs to be some analysis done here. We need to know what would happen if the Cat Fund is 5 percent short, 10 percent, 15, 20, 25, 30, all the way up to 50 percent, what would happen to insurers that write residential insurance in the state of Florida. I'm not aware of anyone doing that analysis.

GOVERNOR SCOTT: Who would do it, Jack?

MR. NICHOLSON: Office of Insurance Regulation.

GOVERNOR SCOTT: Okay.

MR. NICHOLSON: Now, they have probable maximum loss data for these companies. I am fortunate to have data on 11 of those companies because we administer in the Cat Fund the Insurance Capital Build-Up Incentive Program. I have PML data on 11 companies. I did a preliminary analysis of those companies. With a 20 percent shortfall we, again preliminarily, estimate that there would be seven insolvencies with a 100-year event.

GOVERNOR SCOTT: Out of those 11?

MR. NICHOLSON: Out of the 11. Six of those are in the top 15 writers in the state of Florida, by the way. So that would be about 1.2 million policies that would end up in Citizens. That would be a large amount of claims that would go to FIGA. The question is, can FIGA bond.

If we're in this situation and we're not able to bond, the financial markets are hurting, can FIGA issue the debt. So I think that paints the picture pretty solid, because we don't have a way out.

GOVERNOR SCOTT: -- what the answer is.

MR. NICHOLSON: What's that?

GOVERNOR SCOTT: If you can't bond --

MR. NICHOLSON: I'm going to get to the answer.

GOVERNOR SCOTT: Okay.

MR. NICHOLSON: The other problems on here, of course, the growth in Citizens, the cost of private reinsurance after an event could spike. The capacity may not be available. The Cat Fund lacks subsequent season capacity, because that's a big problem, so we're not able to stabilize the impact on the economy, and then what's the impact on the economy, the housing industry, home building, mortgages and so forth.

So let's look at some recommendations. I think that the concept here would be to right-size the Cat Fund. And what does right-size mean? Does anybody have a magic number or a formula? No, they don't. It's a subjective thing. And I'll tell you what my definition of right-size is, is that you need to be structured so you don't have to issue debt that would be a world record in terms of $10 billion or greater. I don't think any municipal debt has ever been issued in one tranche at $10 billion.

GOVERNOR SCOTT: Especially after a catastrophe.

MR. NICHOLSON: Well, in any event, but after a catastrophe could be even other problems. But I think that the right size for the Cat Fund is -- and I didn't really emphasize it back on that chart I showed you. But I had the years, I think it was 2003 to 2006 or something, where we had subsequent season capacity we could fund and we could provide solid capacity.

We don't need to be bonding for more than 5 to $7 billion. That is doable given our assessment base and given the structure of the Cat Fund. It may require that we also use some pre-event financing for liquidity at times or just to have the debt already done so you can rely on your cash resources as opposed to relying on the market. That makes a lot of sense, and to be in the market on a continual basis to create those pre-event notes and have that available.

So we'd like to -- I think the idea would be to structure the Cat Fund so it stabilizes the market, get back to its basic core mission and idea. And it can be done. The State is taking risk today that it doesn't need to take. There's no reason that the State needs to be taking the risk. You've got a private reinsurance industry. It has capacity today. It can take that risk.

ATTORNEY GENERAL BONDI: Governor, may I ask a question? How do we do this? I mean, we're dealing with a house of cards, based on the volatility of the global market.

MR. NICHOLSON: Well, we are.

ATTORNEY GENERAL BONDI: Through no fault of yours, Jack. We appreciate you.

MR. NICHOLSON: We are in terms of the bonding side. And that's what I'm saying. Let's reduce the bonding side. If we get rid of the bonding -- that is our problem. That, clear and simple, is our problem. It's not complicated. And if we do that and we reduce the size of the Cat Fund, we'll also be able to reduce emergency assessments, which is another problem. This six percent, I think we can get that down and still be able to fund our overall capacity.

GOVERNOR SCOTT: You've got a proposal on the next page, right?

MR. NICHOLSON: Right. So there's like six ideas we've been talking about in terms of legislative changes that make a lot of sense. And that would be to reduce the Cat Fund by about $5 billion. I think that's feasible. We reduced it by $11 billion since 2009. That didn't upset the markets. That was absorbed by the private markets. This can be done.

Increase the co-pay. Now, the co-pay is what the insurers pay. That's their skin in the game. We'd like to see more skin in the game to force them to settle claims more fairly. And there were some changes made last session that pay policyholder attorney fees and that sort of thing to be more aligned with what private reinsurance does.

But we had the feeling, settling '04 and '05 losses, that a lot of these losses were being passed to the Cat Fund just because companies could. We want to see more skin in the game for them. This would also cut down on the amount of bonding and the probability of hitting these larger layers.

The retention could be edged up a little bit. And this is only to reset the retention, the insurer deductible, if you will, because it was lowered in 2004 and 2005 to make it more accessible. I think that was -- the Cat Fund is already triggered once every 5.3 years. It's designed to trigger about every eight and a half or nine years. So it really -- this would be appropriate to do.

There is a cash build-up factor that's in the law right now. It was created in the 2009 legislation, 5 percent a year. It's I think currently 15 percent. It goes to 25. But what we're suggesting is continue that to 2018 so it builds up to 50 percent. So that would give more cash in the Cat Fund. Every dollar of cash means one less dollar of bonding that you have to do. So it only makes sense to -- and we're still a lot cheaper than private reinsurance.

I mentioned the reduction in the emergency assessments. Completely eliminate the optional coverage early, no need to phase it out, but to get rid of it completely. Another thing that would help would be change the name of the finance corporation. Instead of the Florida Hurricane Catastrophe Fund Finance Corporation, we've suggested something like State Board of Administration Finance Corporation. The idea would be the same as when Citizens changed their high-risk account to coastal account. This is more representative of revenue bonds. It's not a -- we're not selling cat bonds. We're not selling -- this is not Citizens. And the name has confused people.

And quite frankly, analysts, when they go through their portfolio with their boss, they don't want to show them catastrophe and hurricane in the same portfolio. So it makes sense.

So then the question becomes, you know, do you do a phased-in approach or do you do it all at once. I have a chart here that kind of shows the overall transition. The problem is you're at risk if you do a transition. You're at risk during this period of time. The idea is to absorb these changes. The market may take this --

GOVERNOR SCOTT: The market already decided.

MR. NICHOLSON: Right.

GOVERNOR SCOTT: You can't get the money anyway so --

MR. NICHOLSON: That's exactly right. And that's the argument against. It's just like in '05, the same thing, excuse me, in 2009. It was like we couldn't afford it anyway, but the legislature decided to phase it out, so it's okay.

So, anyway, this would be the basic structure. It represents, you know, more cash, less bonding, less assessments and a greater co-pay for the companies. And this is how the structure would be. So you actually go to the last chart on the right if you do this immediately.

The next slide addresses the rate issue, because that always comes up. You'll say, well, what's it going to cost in rates. And my answer to that is, the market is going to cause the rates to go up because that's what's going to take capacity away. It's not -- and the legislation matches the market. That's what you're doing. This idea of bleeding off the capacity is really to get down to the right size. Until you do that, you're at a lot of risk.

So, sure, this is going to cause -- the capacity and the effect of the market will cause rates to go up by about 10 percent over about seven years, is the way that my analysis would look at this. That's a preliminary analysis, like I said earlier, preliminary. So I don't want to be -- my feet held to the fire on that. But when you look at the cost of not doing this, it's pretty substantial. And that's what we need to evaluate.

And if you're looking at something from a risk management standpoint, it's to identify the risk, evaluate it and then make a decision on how you're going to handle it. We haven't really totally evaluated the risk in terms of the impact. I think once you do that, this will make a lot more sense.

GOVERNOR SCOTT: Because basically you're buying -- then you're buying real insurance.

MR. NICHOLSON: Right.

GOVERNOR SCOTT: Because what you're doing now is you're buying insurance that's not going to be able to pay.

MR. NICHOLSON: That's correct.

GOVERNOR SCOTT: Is basically what you're buying.

MR. NICHOLSON: Right. And I think one of the problems, too, is you're spreading out capacity for initial and subsequent season, because right now my calculations, again preliminary, if you had to buy insurance after a major storm wipes out the Cat Fund's capacity, rates would be guaranteed to go up by a minimum of 26 percent, if you're lucky. If reinsurance prices spike or double, you're talking about 52 percent. That's a premium to the policyholder in the state of Florida.

That's the instability that we don't want to occur. And that's why the Cat Fund was created. So I think this is a way to get us in the right direction. And that concludes my comments.

GOVERNOR SCOTT: Anybody have any other questions? Thank you very much. Great job.

MR. NICHOLSON: Thank you.

GOVERNOR SCOTT: Next is the State Board of Administration agenda, presented by Ash Williams. Good morning, Ash.

MR. WILLIAMS: Good morning, Governor, Trustees. Let's see. To open this morning, as usual, I'll give you an update on the fund. As of last night's close, we stood at $120.3 billion.

GOVERNOR SCOTT: 120.3?

MR. WILLIAMS: Yes, sir, in the Florida Retirement System Trust Fund. Calendar year to date, that's up 44 basis points, which is 123 basis points ahead of target. Now, I would say environmentally, if anything, we are continuing to get more definition of the bad global economic environment.

I was on the road last week, had the opportunity to meet with a number of very, very capable investors from all over the U.S. and other parts of the world. And I actually spoke at an event, and the other keynote speaker was Nouriel Roubini, the famous Dr. Doom.

Now, if you want to hear a depressing lecture on the condition of the global economics situation, talk to Dr. Roubini. Basically, he concludes a couple of things. Number one, there's never been a major situation in history where an asset bubble has ended with anything other than a hard landing. And his assessment is that the asset bubbles in housing and financial assets, et cetera, will likewise have a hard landing, and there will be hard landings in Europe and in China as well.

Admittedly, Dr. Roubini is the negative pole of global view, but nobody ever got hurt being aware of what the negative pole was and thinking about it before they went to sleep every night.

Volatility in Europe and the U.S. has continued to be huge. Consider last week alone, we had one day with a 3 percent move in the U.S. equity market, another day with a 2 percent move in opposite directions. Now, did the facts change in the world in 24 or 48 hours' time in a way to justify that kind of change in valuation, or are we just on the knife edge of balancing fear and greed? I would suggest maybe more the latter.

What this comes down to is what we've talked about many times. We've had too much leverage on the global balance sheets of businesses, consumers and governments for years. We're unwinding that leverage. That's a painful process. And if you think about the four major drivers to economic activity, consumer activity, business investment, construction and government, all four of those areas are handicapped for the immediate future for various reasons.

So I think we're just going to continue to be in a difficult time. And for that reason, investment return assumptions that are between 7 and 8 percent are going to look like pretty lofty goals in the near term.

GOVERNOR SCOTT: Ash, could I stop you?

MR. WILLIAMS: Yes, sir.

GOVERNOR SCOTT: In the Pension Plan, the expectation is we have to get a 7.75 percent return a year, right?

MR. WILLIAMS: Not per year. It's a long-term return assumption.

GOVERNOR SCOTT: Year after year after year, right?

MR. WILLIAMS: Yes.

GOVERNOR SCOTT: And if you look at -- and we've got to make up for the shortfall that we already have. So when you say a 7 to 8 percent return is lofty, what you're saying is it's going to be harder --

MR. WILLIAMS: In the near term, I'm saying in the current environment, if you look out a year or two and say, okay, how do I comfortably say I can hit this bogey, that's a challenge. It's a long-term objective. So the perspective has to be kept in that regard. So you'd be looking for some normality over time.

And if you look at the history of return assumptions in Florida going back 40 years, you'll see the range is from, I want to say seven or seven and a half up to nine and change. It's moved around over time. And likewise the returns have varied from probably minus 20 to plus 40 plus. So there's variance. So what you try to do with the actuarial work is look over time.

The other key thing to understand is when you look at actuarial funded ratios, that's not something we can track day to day the way we can portfolio value or performance. And the SBA itself, in fact, does not own the actuarial calculations. That's done elsewhere.

And there are a lot of variables, like how long people live, what is the growth in payrolls in state and local governments, especially when you consider that 80 percent of our beneficiaries are at the local government level, not the state level. There are a lot of variables there we have nothing to do with.

But I give that general happy background to follow on Dr. Nicholson's presentation. Unless there are any questions, I'll move on with the agenda.

Item 1, request approval of our minutes from the October 4 meeting.

GOVERNOR SCOTT: Is there a motion to approve Item 1?

ATTORNEY GENERAL BONDI: Move to approve.

GOVERNOR SCOTT: Is there a second?

CFO ATWATER: Second.

GOVERNOR SCOTT: Moved and seconded. Item 1 is approved without objection.

MR. WILLIAMS: Thank you. Items 2, 3 and 4 are fiscal determinations relating to various Housing Finance Corporation issues. I would note on all three of these items that we're about to do, 2, 3 and 4, all of these were approved under rules adopted under a prior administration, and none of these three actions results in any debt issuance that would be secured by the full faith and credit of the State of Florida.

GOVERNOR SCOTT: Let's just do them all

together.

MR. WILLIAMS: Okay.

GOVERNOR SCOTT: Is there a motion to approve Items 2, 3 and 4?

ATTORNEY GENERAL BONDI: Move to approve.

GOVERNOR SCOTT: Is there a second?

CFO ATWATER: Second.

GOVERNOR SCOTT: Moved and seconded. Items 2, 3 and 4 are approved without objection.

MR. WILLIAMS: Thank you. Item 5, request approval of a draft letter to the Joint Legislative Auditing Committee affirming that the SBA Trustees have reviewed and approved the monthly Florida PRIME and Fund B management summary reports and actions taken, if any, to address material impacts.

During the third quarter there were no material impacts, and the July, August and September reports are attached.

GOVERNOR SCOTT: Any questions? Is there a motion to approve Item 5?

CFO ATWATER: So moved.

GOVERNOR SCOTT: Is there a second?

ATTORNEY GENERAL BONDI: Second.

GOVERNOR SCOTT: Moved and seconded. Item 5 is approved without objection.

MR. WILLIAMS: Thank you. Item 6, I respectfully request deferral. As I said in my letter last evening, the IAC and the Audit Committee did an extensive meeting yesterday to review various issues that have been brought up at CFO Atwater's request and other issues. And I think it would be appropriate for you to have the benefit of a full report from that body, which we'll have at the December quarterly meeting. So I respectfully request deferral of Item 6.

GOVERNOR SCOTT: Is there --

CFO ATWATER: And, Governor, I appreciate the executive director's position on that. We had also -- we had voted on, as trustees, in May to have an outside set of eyes to look at our compliance and our risk management. That report has become available of just recent, and I believe it would also be valuable that we have at that meeting the feedback as requested from us from the Audit Committee, maybe the investment committee as well, on their take on that. So I would appreciate and respect the executive director's position that we withdraw the item.

ATTORNEY GENERAL BONDI: Second.

GOVERNOR SCOTT: Moved and seconded. Show Item

6 is withdrawn without objection.

MR. WILLIAMS: Thank you. Item 7, request approval of the appointment of Mr. Michael Price to the Investment Advisory Council.

GOVERNOR SCOTT: Is there a motion to approve Item 7?

ATTORNEY GENERAL BONDI: Move to approve.

CFO ATWATER: Second.

GOVERNOR SCOTT: Moved and seconded. Item 7 is approved without objection.

MR. WILLIAMS: Thank you. Item 8, request approval of the appointment of Gary Wendt, Mr. Gary Wendt, to the Investment Advisory Council.

GOVERNOR SCOTT: Is there a motion?

ATTORNEY GENERAL BONDI: Move to approve.

GOVERNOR SCOTT: Is there a second?

CFO ATWATER: Second.

GOVERNOR SCOTT: Moved and seconded. Item 8 is approved without objection.

MR. WILLIAMS: Thank you.

GOVERNOR SCOTT: Thank you very much.

GOVERNOR SCOTT: Okay. Now we're going to move on to the Department of Law Enforcement agency, presented by Commissioner Jerry Bailey.

MR. BAILEY: Good morning, Governor, Cabinet.

GOVERNOR SCOTT: A 40-year low on crime rate, right?

MR. BAILEY: I'm sorry?

GOVERNOR SCOTT: Forty-year low in our crime rate in our state.

MR. BAILEY: Both the rate and the volume, Governor. Best it's been in four decades. I have three items on your agenda this morning. The first is our '11-'12 first quarter performance report. I hope you see there that our numbers remain strong. But behind the numbers, let me give you some highlights for July, August and September.

In partnership with the Department of Health, we inspected Florida pain clinics to ensure compliance with our prescription drug law. And in that -- just in this quarter alone, we seized 105,000 pills from those institutions. An additional 360,000 pills were voluntarily relinquished by the same group. And these efforts, along with the regional drug task forces, resulted in taking 865,000 pills off the streets.

GOVERNOR SCOTT: Commissioner, first off, congratulations, I think everybody up here congratulates you on that.

ATTORNEY GENERAL BONDI: Thank you.

GOVERNOR SCOTT: When would -- like last year, 2010, I think, what, 7.4 people died a day of legal drug overdoses, right? When will we start getting data on 2011? I know it's delayed, because everybody doesn't report when they're --

MR. BAILEY: Correct. And as you know, we serve as staff to the Florida Medical Examiners' Commission. And the numbers come to us from the medical examiners. And because of the complex operations of what they do, some of the autopsies, when they will discover whether the drug was the cause of death or a contributor to the death, some of the toxicology reports, they're sent off to a variety of places. It takes a long time to get those back. So we always have a several-month lapse.

The next report you will see will be right after the start of the calendar year. The work of those doctors, the way -- a lot them save information and send it to us in bulk. As the deadlines approach, the submissions will approach.

We would like to have it on a more timely basis, but we only have partial information on those drug tests at this time. But come February, we will have a brand new report that will give us a better snapshot of where we are with this particular problem.

ATTORNEY GENERAL BONDI: And, Governor, we were also going to reach out to all the medical examiners to ensure consistency in the way they're documenting and the drugs that they're reporting.

MR. BAILEY: Yes.

GOVERNOR SCOTT: And we also have a concern about the pregnant women with regard to drug usage, right?

ATTORNEY GENERAL BONDI: Tremendous concern, yes, Governor.

GOVERNOR SCOTT: Thank you.

MR. BAILEY: The program is ongoing. As you know, we have seven sheriffs and seven chiefs involved. Even though we've been doing this since March, the intensity has not waned, and you will be proud of the job that local law enforcement continues to do with this one particular problem that we have.

Governor, as you know, we launched the If You See Something, Say Something Program to encourage our citizens to report suspicious activity. We located and arrested a Florida murderer in Colorado after an extensive search by Florida authorities. In conjunction with the Florida Innocence Commission, we developed new eyewitness procedures to use in lineups that have been adopted by almost all of the sheriff's departments and police departments in the state. That's going to give us a new degree of consistency in that particular operation.

We arrested 25 individuals in the Pensacola region as part of an undercover operation targeting individuals using the Internet to sexually exploit our children.

Arrested 12 individuals as part of two fraud schemes, one in our Miami region, one in the Tampa Bay region. Those schemes had resulted in more than $64 million against 100 victims in our state. Office of Financial Regulation was a partner in the Tampa Bay operation.

And I would be happy to answer any questions on our first quarter performance report.

GOVERNOR SCOTT: Does anybody have any questions? Is there a motion to approve Item 1?

ATTORNEY GENERAL BONDI: Move to approve --

COMMISSIONER PUTNAM: So moved.
ATTORNEY GENERAL BONDI: Second.
GOVERNOR SCOTT: Moved and seconded. Item 1 is approved without objection.
MR. BAILEY: Governor, the second item brings to you nine rules that we've identified to repeal as a part of our comprehensive rule review that was specified in your Executive Order 11-01, and we coordinated this with the Office of Fiscal Accountability and Regulatory Reform. I would be happy to answer any questions on these rule repeals.
GOVERNOR SCOTT: Any questions? Is there a motion to approve Item 2?
ATTORNEY GENERAL BONDI: Move to approve.
GOVERNOR SCOTT: Is there a second?
CFO ATWATER: Second.
GOVERNOR SCOTT: Moved and seconded. Item 2 is approved without objection.
MR. BAILEY: My final item has to do with proposed rules. And, again, these rules have been provided to the Office of Fiscal Accountability and Regulatory Reform. Each of these are amendments or proposed amendments to existing rules. We anticipate bringing these back to you sometime after the beginning of the calendar year.

Six of these rules involve the Criminal Justice Standards and Training Commission and include things like changes to the good moral character definition for law enforcement and correctional officers. We're implementing a new computer-based state officer certification exam. And we're implementing a new correctional basic recruit program.

And the remaining proposed changes, both for the Criminal Justice Standards and Training Commission, FDLE's information program and the medical examiners' program, involve housekeeping and statutory changes.

GOVERNOR SCOTT: Any questions? Is there a motion to approve Item 3?

COMMISSIONER PUTNAM: So moved.

GOVERNOR SCOTT: Is there a second?

ATTORNEY GENERAL BONDI: Second.

GOVERNOR SCOTT: Moved and seconded. Show Item 3 approved without objection.

MR. BAILEY: Thank you very much.

GOVERNOR SCOTT: Thanks, Jerry.

GOVERNOR SCOTT: All right. Next is a presentation regarding the Florida Land Programs, presented by Clay Smallwood. Good morning.

MR. SMALLWOOD: Good morning. Thank you. Good morning, Governor Scott, Attorney General Bondi and CFO Atwater and Commissioner Putnam. I appreciate the opportunity to be here and talk to you and also to serve in the role of director of DEP, Division of State Lands. I've been here about two months now. And it's been exciting to go through a little force-feeding to learn this and be able to come talk to you a little bit about our acquisition programs in Florida. I hope this presentation will take about 20 minutes, in case you have some questions, and then we'll discuss it as long as we need to.

My past life was in the private sector. And while private sector acquisition and public sector acquisitions are significantly different, there are some commonalities and some things that are similar in both that we need to kind of think about.

First we must understand and agree on the goals and procedures and the priorities for acquisitions. Our acquisition strategy is dictated by the economy, and we need a strategy in place to determine how we're going to manage the lands that are in our inventory. So today I want to talk primarily about the State's process of acquiring lands, and most of what our current land inventory is, I want to talk about that, and then where we go from here.

And I look forward in several weeks to be able to come back to you and talk to you in more detail about our land management and how we manage the lands that are in the State's inventory.

But first, I want to start at the beginning, just very briefly. In 1845 Florida became a state and was granted a half a million acres of internal improvement lands. We were expected to sell these lands to fund the internal improvements in the state, whether it be for roads, bridges, internal communications, whatever it took to help our state grow and prosper.

In 1855 the legislature created the Internal Improvement Fund and named the governor and the cabinet as the trustees for the Internal Improvement Trust Fund. That's the hat you wear when you sit as the Board of Trustees for the Internal Improvement Trust Fund today.

Florida is composed of about 34.7 million acres of uplands. And 72 percent of those, or about 25 million acres, are privately owned.

Twenty-eight percent, or 9.7 million acres, are publicly owned. You see in the little pie chart to the right there a break-out of that 28 percent. The big three ownerships are water management districts, which have about six percent, the federal government, and then the Board of Trustees owns about nine percent.

This is a blank canvas of the state of Florida. I want to show you spatially how that 28 percent kind of populates the state and bring it in a little bit at a time. But first I want to show you the sovereignty submerged lands as they exist in the state.

These are about 9 million acres that are not included in the 28 percent. And I'm not going to talk much about them today, other than just be aware that there's about 9 million acres of sovereignty submerged lands that the State of Florida owns. And this is kind of -- sort of where they are, if you will.

These are state-owned lands as they exist within the state today, and our inventory includes state parks, state forests, land that exists around critical water bodies. This also includes non-conservation properties, which can be universities, community colleges, state office buildings and similar things.

I think I went the wrong way there. Okay. Now I want to bring in the water management district lands and let you see how those coexist with the state-owned lands. We have five water management districts that own about 2.1 million acres in the state. And you'll see that most of the these lands tend to surround large water bodies. You can identify, I think, the St. Johns River here, as well as the Everglades and the Suwannee River on this map.

Now we look at city- and county-owned lands that are in orange. These lands, a lot of these lands were purchased through grants that came, were funded by Preservation 2000 as well as Florida Forever funds through the Florida Communities Trust programs. Not all the lands were purchased with those funds, but a lot of them were. And so you can see they also complement our previous ownership.

Now I want to bring in the federal ownership. And federally-owned lands you'll recognize from Eglin Air Force Base to Apalachicola National Forest there and Everglades in the south part of the state. Again, these are federally owned lands.

So I'm going to turn them all one color, so you can see the 9.7 million publicly owned acres in the state of Florida and how that spatially is represented within the state. Again, remember that there's an additional 9 million acres of sovereignty submerged lands that the State owns that we're not showing on this map and are not included in that 28 percent.

The Board of Trustees owns about 3.3 million acres of lands. And of that, about 3.1 million acres are conservation lands and just under a quarter million acres are non-conservation lands. Conservation lands are purchased to protect water quality and quantity, also to provide outdoor resource based recreation. Non-conservation lands, again, as I previously said, can be universities, colleges, detention centers, office buildings, things that are not intuitively conservation purposes.

Our water management districts own about 2.1 million acres of land, and they're titled individually to the five different water management districts. They support their missions by purchasing tracts of land around these larger water bodies that we already pointed out. Excuse me. I got behind on the slides or I'm going the wrong way. I don't know if you can help me. I'm on slide 12.

Much of these lands are open to the public, free to the public to access to use for outdoor-based recreation. And, you know, these activities could be hunting, fishing, hiking, canoeing, kayaking.

As I previously mentioned, I spent about 30 years in the private sector, and a lot of the decisions we made at that time about acquisition sales were based on the fiduciary responsibility that we had to our shareholders of the company. I still feel like I have that fiduciary responsibility, but today that fiduciary responsibility is to the taxpayers and the citizens of the state of Florida. And as the staff to the Board of Trustees, I feel like it's my job to ensure that the Board of Trustees gets the maximum return for their dollar. We need to make sure every dollar we spend is in the best interest of the citizens of the state of Florida.

Our constitution states -- I'm going the wrong way again. The constitution states that it will be our policy to conserve and protect our natural resources and scenic beauty. One of the tools that we use to do this has been through land acquisition programs. And there are other tools that I want to just talk briefly about.

But for over four decades we have acquired land for conservation purposes. And I think our children and our grandchildren are really going to thank us for the special places that we've protected around our rivers, beaches, parks and greenways. These lands are also a huge ecotourism draw for the state of Florida. And our visitors, when they come to the state, they bring a lot of dollars with them. And I want to give you a couple of examples of the dollars they bring with them.

Florida state parks last year welcomed more than 20 million visitors to the state parks. They had a direct annual economic impact of almost $1 billion on the communities around the state parks that they visited. If you try to put this in terms of a return on investment, if you look at the budget for the state parks versus this $1 billion in direct economic impact, for every dollar that the State spends on state parks, about ten dollars comes in as direct economic impact.

Another example of this is if we look at the Florida Forest Service. Same last year, they had about 2 million visitors that visited one of our 35 state forests. They also -- the Florida Forest Service last year harvested about 450,000 tons of wood. And the direct result of that was about a half a billion dollars in annual economic impact to the state of Florida, while it also preserved about 2,500 jobs while they harvested that timber from state lands.

So, again, we've got special places that people love to see, and they bring their dollars when they come and spend it in Florida, and we like to see that.

Our next slide, I want to -- talks about the eight acquisition programs that we've had since 1963. These programs have resulted in about 3.8 million acres acquired. And we spent, as you can see, quite a bit of money during those programs. Since its inception, Florida Forever has acquired over 680,000 acres, and collectively Preservation 2000 and Florida Forever has acquired about 2.4 million acres of land.

I want to talk a little bit about the funding source. And the source of most of the funds for P2000 and Florida Forever have been through bonding. And this chart will show you. The blue indicates the years that bonds were sold to acquire the funding, and the red indicates years that we were able to -- or the State was able to appropriate actual cash and we did not have to float any bonds for that funding.

You'll notice in the fiscal year '06-'07 that about $610 million was appropriated in cash. That was also the year that Babcock Ranch was purchased. And that was a special legislative appropriation to do that.

The next slide talks about, you know, how much cash that we've spent and how much cash that is still available to us. Our total appropriation, since Florida Forever has been in existence in 2001, has been about $2.9 billion. We've actually spent about 2.8 billion of that, leaving a balance of $126 million. Of that $126 million, there's $62.8 million that have been approved with commitments by the various boards. Some of that has been approved by the Board of Trustees. Some of it has been approved by water management districts.

Of that $62.8 million, there's about $40 million that has been set aside to settle condemnation suits. There's about $13.8 million that has been allocated towards capital outlay projects, and then about $9 million are in actual land acquisitions that are in some process of closing.

That leaves a balance after the approved appropriation that you can say is in the bank today of about $63.8 million. Those are projects that have been identified. There have been some negotiations that have gone on or discussions between landowners and the appropriate agencies that have been doing that. They are what I call in the pipeline.

And so if all those proceed, they would eventually come to either you or the water management districts for approval to purchase. But none of those dollars are at the point today that there's been signed contracts and they're proceeding to closing.

Once we -- I guess once we have the money and spend the money, then we have to -- or bond the money, then we have to pay for those bonds. And the revenue stream that has been dedicated to pay for those bonds is documentary stamps. The first 63.31 percent of our documentary stamps goes towards the debt in Florida Forever, P2000 and Everglades bonds that have been previously sold. This chart shows that revenue stream. And you will see that, I think it is '05-'06 was the year that we brought in over $4 billion in documentary stamps.

The point of the slide to me is, as you can see in today's economy, our documentary stamps are probably about as low as they have been in some time, and it has still been enough revenues for us to, using the 63.3 percent, to pay for our debt service. We've still been able to service that debt and even return a very modest amount to the general revenue fund when we finished paying for those. So that's the good news. Yes, sir.

GOVERNOR SCOTT: Do we just pay the interest? We don't pay down the debt with that money at all? If we don't need all of it, it goes back into general revenue? Is that what happens?

MR. SMALLWOOD: Yes. There's a formula for how that's spent, yes, sir.

GOVERNOR SCOTT: We don't ever pay down any debt on that?

MR. SMALLWOOD: My understanding is we at times -- we don't pay debt with the excess funds, no, sir.

GOVERNOR SCOTT: We don't, okay. So it's just the debt. We would just have to pay the debt that was due under the normal --

MR. SMALLWOOD: Yes, that's correct, yes. On the next slide, we talk about the actual debt itself. Since P2000 and Florida Forever, we have incurred a total of about $7.8 billion in debt. Of that, we have about $2.7 billion remaining in debt. And those are estimates going forward, depending on the bond markets and if we get favorable rates and refinance, which we have just heard in several cases this morning that that's a very volatile market, and that may or may not happen.

But you'll see a rather dramatic decrease in our debt load in 2013. June of 2013 the Preservation 2000 bonds are paid off, and that is just the remaining Florida Forever bonds that are paid from that date forward. And if we do not bond anymore, in 2028-'29 fiscal year, then our debt will be paid for and we'll be free and clear again. Yes, sir.

GOVERNOR SCOTT: Is the interest rate, is it fixed on all these? Do you know?

MR. SMALLWOOD: I'm not sure. I think Ben Watkins is here and could possibly address that.

MR. WATKINS: Yes, sir. They're all fixed-rate bonds, no floating rate debt.

GOVERNOR SCOTT: Ben, do we have any debt where the State is on the hook that is not fixed interest rate?

MR. WATKINS: A hundred million in Everglades Restoration Bonds are the only variable-rate bonds that we have outstanding. Everything else is fixed, long-term fixed rate.

GOVERNOR SCOTT: Thanks.

MR. SMALLWOOD: So let me recap for a minute the progress we've made. This is a map of Florida around 1990 that shows the publicly owned lands at the beginning of Preservation 2000 and then Florida Forever that was the subsequent program. This includes federal lands as well as state-owned lands. And it encompasses about five and a half million acres.

Now, if we think about how we progressed from that point and how we identified lands that the State bought during the last 20 years, when Florida Forever was authorized in 2001, the Acquisition and Restoration Council was formed, and this was called ARC. ARC is composed of four appointees of the governor. It's composed of -- as well as representatives from the FWC, Department of Agriculture & Consumer Services, Department of State and DEP.

ARC evaluates, selects and ranks the projects that come before it in order of priority. And then those projects are given to the Board of Trustees semiannually. The Board of Trustees, if they approve those, that sets the -- that allows that priority list to become the work plan that historically we have worked through and used to purchase land.

Currently, there are 113 projects on the ARC priority list in all categories. It's about 1.9 million acres. And in today's dollars, it would take about $11 billion to close those transactions. This next slide shows you, fast-forward from the last slide 20 years, it shows you the addition of the 3.8 million acres that were purchased under P2000 and Florida Forever and also adds the ARC priority list, again, which is 1.9 million acres at a cost of $11 billion.

As you can see, we have a very long and ambitious list here. This list represents the priorities of five previous administrations that began with Governor Martinez and has gone through 20 years of, for the most part, booming economies. I believe we can all look at this list and agree that every piece of property on this list is not feasible for us to buy or is it prudent in the current economic climate that we're in.

But I do believe we have a responsibility to our taxpayers to take a good look at this wish list and our current inventory and ask ourselves several questions. Do we own land in the right places? Have we protected what needs to be protected? What have we missed? And are there parcels of land that we need to think about surplussing and use those funds to purchase higher quality conservation lands around springs or other water bodies? These are just a few of the questions that I've come up with in the two months since I've been here.

We've done a great job of identifying and purchasing land, but I think we need to do more now. That's why I've asked our staff to conduct a more thorough analysis of what lands we own and make some recommendations based on our current land inventory. Once that analysis is completed, I'm confident that we'll have some of the answers to these questions and we can develop a better strategy as we go forward.

As a native Floridian, I'm very proud of what the State has done over the last 20 years in the land buying program. Our future generations are going to be able to enjoy Florida the way we currently enjoy Florida. But I think there's also a balance going forward. And this is a very challenging economy in today's times, and so we need to set our priorities.

We need to ensure that Florida has enough clean water for our future generations. We need to protect our economic drivers and provide military buffers, or buffers around the military bases. We need to protect the health of our estuaries and critical natural resources. And we need to continue to provide recreational tourism opportunities for our Floridians and our visitors as they come to our state.

I think we, in our bag of tools that we use to do this, we need to seek out partnerships that help better leverage our financial resources. We need to consider more conservation easements, and we need to put strong emphasis on only making those purchases that are absolutely critical to our state.

It's been my pleasure to talk about this with you today, and I'm looking forward to coming back to you in a couple of weeks and talking again about how we manage these lands. I'd be glad to entertain any questions.

GOVERNOR SCOTT: Does anybody have any questions? Good presentation. This was very helpful.

MR. SMALLWOOD: Thank you. We had a couple of people from the public that would like to make comments about this also. And I'd like to, at least with your permission, introduce Janet Bowman as the first speaker.

GOVERNOR SCOTT: Good morning, Janet.

MS. BOWMAN: I'm Janet Bowman with the Nature Conservancy in Florida. And for 50 years we've been working with the State and particularly with the Board of Trustees as a partner in identifying and acquiring lands for preservation. And I just wanted to talk to you a little bit about -- first of all, I really appreciate Clay Smallwood's presentation and Secretary Vinyard and really thank him for how accessible he's been in working with him on these issues.

We, of course, being in the conservation business, are addressing the same issues that you all are. And we've really, in the last several years, been thinking about our priorities and really how to maximize and leverage conservation dollars in this tight economy. So a year ago we prepared a document called "Connecting Florida Lands" that I circulated to y'all. And it really lists, I think, some of the same priorities that Mr. Smallwood identified. And I just wanted to stress those.

The first is to focus on acquiring key linkages that really leverage the acquisitions that we already have. And to give you an example, there are a couple of key pieces in the Wekiva area that, if we were to purchase, would complete a corridor all the way from Wekiva Springs State Park all the way through the Ocala National Forest, through the Osceola Forest, to Georgia.

So that's an example, if you buy a couple of missing puzzle pieces, you get this bear corridor that doesn't currently exist. And there are several other examples in Florida. So I think it's important that we identify what those are and really focus our dollars on those.

Second is to focus on conservation easements because, again, you're leveraging dollars, but most importantly, the State doesn't incur recurring land management dollars. In 2008, when the program was reauthorized, one of the important new components was some funding for the Rural and Family Lands

Program that Commissioner Putnam administers. And we think their expenditure of dollars for ag easements has been a very effective use of Florida Forever funds and again something, going forward, is an important tool in the toolbox to both provide conservation and to protect ag lands.

And agriculture is certainly of increasing importance in Florida's economy, particularly with the decline in housing. So we think that's very important.

And third is leveraging funds that rely on partnership opportunities. Particularly with the military, we've been very active in working with military bases in Florida on bringing down REPI money, which is Readiness and Environmental Protection Initiative. Last year Florida received $9.7 million in funds for buffering lands around bases to protect military mission and to provide conservation value. So if we have a little bit of money, we can bring down more federal money and leverage that.

And then, finally, having some state land acquisition monies also helps to bring down Farm Bill program money. And we've been working at the federal level to bring down more Farm Bill money to

Florida. Recently Florida received $100 million in the Northern Everglades area for Farm Bill conservation easements, ag easements.

So, again, it's important to have capacity in Florida. We should be smart about how we use it. Certainly in the current economy it's difficult to provide additional bonding. But in several years that capacity will come back, and in the meantime we hope that there's some funding so that the work can continue. Thanks.

GOVERNOR SCOTT: Thank you very much.

MR. MULLER: Good morning. I'm Jim Muller with Muller & Associates for the City of Marathon. I appreciate the opportunity to speak with you today, and I also appreciate the update provided by Clay Smallwood in the Division of State Lands on the status of land acquisition in Florida.

The City of Marathon would like to suggest Boot Key as an example of the type of project the State would acquire going forward. The City has been meeting with the Division of State Lands and also your staff, briefing them on this project. It's an 1100-acre undeveloped island within the city of Marathon in the Florida Keys. It's highly ranked according to Florida Forever criteria. It's part of the Florida Keys Ecosystem Florida Forever Project. It's number one in one of the categories in which they rank the projects.

The City identified a potential source of matching money and made the effort to go out there and secure the money. And so they have a grant for that. And they also have local money that they want to put in towards the acquisition.

One of the important parts of Boot Key is it is a critical component in the City's economic development plan. The City is reliant on tourism for their economy. And together with three other already protected projects, Boot Key will be one of the cornerstones of them developing and enhancing their tourism. They want to have the true Keys experience, which is more of an outdoor experience, family-oriented offerings there in the City of Marathon.

A unique aspect of this project is that it is a partnership between the State and the local governments of the Florida Keys. Back in 2004, as part of the Keys work program, the State said that they would focus on environmental land acquisition, and the local governments agreed to focus on improving wastewater and stormwater facilities in the Keys.

During your visit to the Florida Keys, Governor Scott, you noted the advancements that the City of Marathon has made and their leadership in the wastewater and stormwater. By March of 2012 the City of Marathon will have met all of the Keys Work Program requirements for stormwater and wastewater and spent over $100 million in doing that.

The City also acknowledges the extraordinary effort that the FDEP's Division of State Lands has made through their Florida Keys acquisition effort with the Florida Forever program. We feel that the Boot Key acquisition is an important component of that effort.

So, overall, it meets a lot of the Florida Forever criteria; providing matching funds, that's the economic link, the leadership that Marathon has shown in water quality improvement in the Keys, and matching up, which was talked about today, it deals with clean water. It is part -- it's within the Florida Keys National Marine Sanctuary. It's important to the water quality of that. Tourism, economic development and the partnership.

So the City of Marathon would appreciate the Governor and Cabinet support to move forward to acquire Boot Key through the Florida Forever Program. Thank you.

GOVERNOR SCOTT: Thank you very much. Good morning.

MR. WARD: Good morning, Governor and Cabinet. My name is Carlton Ward, Jr., and I'm a photographer from the Tampa area. I've photographed all over the world. And in the last several years photographing in Florida, I'm always convinced there's no more beautiful place than our state. The past six or seven years of my life have been spent photographing on Florida's ranch lands. And I produced a book called *Florida Cowboys, Keepers of the Last Frontier*. And it looks at the role of these working agricultural lands and in the future protecting the water and the wildlife and the agricultural production and the heritage for the rest of us.

I speak from the ranching perspective. I'm an eighth generation Floridian, and that's where my experience is drawn. But I know that in the timberlands and in the groves and growers and producers across the state, the agriculture and the -- agriculture and environment are in many cases in the same boat.

So during my time working on the Florida

Cowboys book and photographing for calendars for the Cattlemen's Association each year, I spent a lot of time crisscrossing the Florida heartland and spending time in what we describe now as the Northern Everglades.

And I met many new heros during that time. Got to reconnect with my Uncle Doyle and learned about his land conservation ethic and believing that the land belonged to God and not to him and he was just there to take care of it for him.

I met people like Cary and Lane Lightsey, who for nearly two decades now have been putting land in conservation easements, expanding the land that they are protecting and doing a great service for all of us in doing so. People like the Adams Ranch and Bud Adams, who with their environmental stewardship and leadership are really -- are showing what can be done for the land in private hands on a generational perspective.

I also met people like Mason Smoak, a grover and ranch person from Highlands County, and the researchers he was working with, working in stewardship of the culture and the heritage and for the wildlife. They're studying a population of black bears in Highlands County, which is a lesser known and smaller population of bears that is a stepping stone for connectivity throughout Florida, and just the tremendous stories that came out of that.

And so this sense that the future of agricultural in Florida, the future of our endangered species, the future of hunting and fishing, the future of the Everglades, the future of our water supply, all rely on the same common ground. And that's that idea of the functional, intact, green infrastructure that they all hold in common together.

I'll share a brief story of a bear that I met. He got named M34. My friend and colleague Joe Guthrie put a GPS collar on this bear near Sebring. And during a two-month period in early 2010, this bear went on a 500-mile walkabout. It went 105 miles from north to south, and during its meanderings showed that there's functional connectivity between Babcock Ranch and Fisheating Creek and the Avon Park Air Force Range and the Nature Conservancy's Disney Wilderness Preserve, connecting the dots through this whole Florida heartland.

And so it really illustrates that we still have a connected corridor throughout Peninsular Florida. It's quite amazing, in a state of 18 million people, that we still have the chance to keep these things connected. And we have a very narrow window of time to do so.

I don't know if the projections still hold, but if you've seen those population 2060 projections, if the state's population is going to double, to accommodate that, we really need to think proactively about the connectivity.

So to showcase this, starting in January, I'm going to lead a small team on a hundred-day, thousand-mile expedition. We're going to start in the Everglades. Then we're going to walk and paddle and ride horses and work our way all the way up through Peninsular Florida to the Okefenokee Swamp, to illustrate that those are still connected. So, of course, all of you are invited to come walk with us, if you're willing.

GOVERNOR SCOTT: During session, it might be fun.

MR. WARD: Yeah. Well, take a one-day weekend trip and come hike or paddle. But it's just a phenomenal opportunity, when you look at it, and it shows these overlapping priorities. I mean, I'm really just a photographer working in this realm, but it's been exciting to see the Department of Environmental Protection's Office of Greenways and Trails, the Florida Forever Program, the Fish & Wildlife Commission's Cooperative Conservation Blueprint, USDA's investment in conservation easements, the Fish & Wildlife Service's interest in the Northern Everglades all point to some of the same common ground.

And so in closing, I would just suggest that we please try to think about connectivity, as the agencies are doing so well in our priorities, and also think about the conservation easements, because it's really one of the most effective ways to protect the agricultural production, protect the ranching and other multi-generational cultures and protect the environmental services that these lands provide for all of us in a fairly efficient way that keeps them on the tax roll and in private management in perpetuity. Thank you.

GOVERNOR SCOTT: Thank you very much. Thanks, everybody. And we look forward to the next presentation.

COMMISSIONER PUTNAM: Governor.

GOVERNOR SCOTT: I'm sorry.

COMMISSIONER PUTNAM: Just a couple of things to put this in perspective. This is one of those days when we really kind of get the broad range of our responsibilities on the Cabinet, go deep in the weeds on the Cat Fund, you go deep in the weeds on the 10 million acres of land that we're responsible for being the board of directors to, double that number if you include sovereign submerged lands.

We traditionally have measured success on these land programs by how many acres we buy, because there was always plenty of money. Well, now the money is gone, and we've got to get a lot more creative about how we continue to fund these programs that all of us are proud of. We've got the best state park system in the nation. We've got state lands that are beyond compare in beauty. And I salute Carlton for his journey to really draw attention to this.

A decade ago nobody really wanted to talk about conservation easements. Now they may be our only way for preserving some of these things. And so as we get into this conversation and we get into phase two of the conversation with Clay and Secretary Vinyard on the management of these lands, it's going to become pretty important. We're managing

10 million acres. The single largest private land owner in the state has got a million. So just for some perspective here.

And we have extraordinary resources that can be utilized to help pay for improvements for the public recreation or long-term endowments for managing these lands and things like that. We also have opportunities, because of the buying spree that we were on, that resulted in some phenomenal protective accomplishments.

Frequently, when we buy land, particularly if there's a large tract of land purchased, a St. Joe purchase, a Plum Creek purchase, a Georgia Pacific purchase, they may not all be contiguous. And so you could run your parcels that are disconnected, that are, say, less than 500 acres or less than 1,000 acres or less than 50 acres, I mean, you can dial it in based on which part of the state, and suddenly you have -- you have trading stock to go get inholdings, which is what we approved at the last cabinet meeting, so that you're connecting and filling in the gaps of things that you really want, or you have an ability to swap out. Not all conservation lands are created equally. You can swap out things that were picked up as part of a larger purchase to go complete the Wekiva corridor or the bear corridor or a panther corridor or complete an Everglades purchase.

We start a lot of projects. We don't finish a lot of projects. And there's an opportunity here as we sharpen our pencil, I think, to really think carefully, when you look at this mosaic of lands purchased, how we fill in the gaps to maximize what we're protecting, whether it's water recharge, wildlife corridors, a whole host of things that go into that calculation, and keeping in mind that the only reason why we have land that is desirable for public purchase is because a private landowner has been a good steward of it.

The reason why we have these lands that are so spectacular that, you know, we show the springs and we show the coasts and we show these magnificent timberlands and all these things, somebody has been taking care of it for a long, long time, that we decide that it's spectacular enough to put it in the public trust.

And I think that that needs to constantly be at the forefront of our mind, that good land stewardship on the private sector has made a lot of these lands possible for public protection.

GOVERNOR SCOTT: Plus there's a big opportunity with working with the federal lands that are here and making -- and also trying to make sure that it's coordinated, what you can do and what you can't do on the different federal and state lands, which I know is something everybody is focused on.

COMMISSIONER PUTNAM: That's right. And that management conversation that I guess is going to take place in a couple of weeks is going to be --

GOVERNOR SCOTT: Right. I think it's going to be very good for the state. All right. Thank you very much, Clay.

GOVERNOR SCOTT: And now our last agenda is the Board of Trustees of the Internal Improvement Trust Fund, agenda presented by Secretary Herschel Vinyard. Good morning.

MR. VINYARD: Good morning. What were the odds that I wore my purple tie today?

ATTORNEY GENERAL BONDI: All right, Herschel.

MR. VINYARD: Governor and members of the Cabinet, we have two very quick items. The first one is approval of minutes from your September 20 cabinet meeting.

COMMISSIONER PUTNAM: So moved.

GOVERNOR SCOTT: Okay. Is there a second?

ATTORNEY GENERAL BONDI: Second.

GOVERNOR SCOTT: Moved and seconded. Item 1 is approved without objection.

MR. VINYARD: The second item is the Department requests that we withdraw Item Number 2.

GOVERNOR SCOTT: Is there a motion?

ATTORNEY GENERAL BONDI: So moved.

GOVERNOR SCOTT: Is there a second?

COMMISSIONER PUTNAM: Second.

GOVERNOR SCOTT: Moved and seconded. Item 2 is withdrawn without objection. Thank you very much.

And Attorney General Bondi wants to introduce some individuals.

ATTORNEY GENERAL BONDI: Very quickly. In the audience, Cherlyn Stokes, who I went to high school with, and her sister Janeen, raise your hand, please, and Janeen's son Jesse.

GOVERNOR SCOTT: Like five years ago, right?

ATTORNEY GENERAL BONDI: Yeah, that's right. They are up here for a very important event, which is juvenile arthritis. And Jesse here and his mom have arthritis, and Jesse is an advocate for juvenile arthritis. So thank you, Jesse, for all your work.

(Applause)

GOVERNOR SCOTT: Does anybody else have anything they'd like to add? Okay. The meeting is adjourned.

(Whereupon, the meeting was concluded at 11:00 a.m.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

I, Jo Langston, Registered Professional Reporter, do hereby certify that the foregoing pages 4 through 85, both inclusive, comprise a true and correct transcript of the proceeding; that said proceeding was taken by me stenographically and transcribed by me as it now appears; that I am not a relative or employee or attorney or counsel of the parties, or a relative or employee of such attorney or counsel, nor am I interested in this proceeding or its outcome.

IN WITNESS WHEREOF, I have hereunto set my hand this 30th day of November 2011.

JO LANGSTON
Registered Professional Reporter