



# Memorandum

**To:** The Board of Directors of Connecticut Foundation Solutions Indemnity Company, Inc. ("CFSIC")

**From:** Michael Maglaras, Superintendent

**Date:** September 9, 2019

**Re:** **Annual Report**

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I am pleased to provide you, in my firm's capacity as Superintendent of CFSIC, with the first Annual Report summarizing CFSIC's impact on the crumbling foundations natural disaster.

## **Date Range of Data**

All data is valid as of either July 31, 2019 or August 31, 2019 depending upon the data set utilized. The infographics, which are included as attachments to this report, are based on data derived from CFSIC internal resources, including its electronic application and supporting claims management systems, and its accounting and financial transaction records.

## **Revenue to Date**

To date, CFSIC has received \$40,327,062 in revenue. This consists of a total of \$40,000,000 received in three tranches by way of allotments approved by the Connecticut Bond Commission and/or the Connecticut Department of Housing, \$318,062 in investment income, and \$9,000 provided as an education grant by the Connecticut Association of Realtors.

## **Total Anticipated Additional Funding**

In addition to the actual revenue received as noted above, CFSIC has budgeted an additional anticipated \$85,500,000 in funding (not inclusive of investment income) projected to be received before its statutory sunset date of June 30, 2022. Of this amount, \$60,000,000 is prescribed by statute as the remaining funding to be received from the Connecticut Bond Commission, in three remaining installments, between the period of the date of this memorandum and CFSIC's statutory sunset date. CFSIC has been reliably informed that its next \$20,000,000 will be authorized at the September 27, 2019 scheduled Bond Commission hearing. No date has been set for any funding beyond that point, for any fiscal year beyond that point, and no definitive commitment has been provided to the company that the remaining \$40,000,000 in funding will in fact be allocated at all.



With respect to the remaining \$25,500,000, CFSIC expects to receive approximately \$8,500,000 at some point in June of 2020, and then subsequently the same projected amount in June of 2021 and June of 2022 respectively, from CFSIC's share of the \$12 per commercial homeowner insurance policy annual surcharge. While CFSIC has budgeted this revenue, based on estimates provided to us by the Connecticut Insurance Department, CFSIC does not have access to those funds now and will not, with respect to the first allotment of those funds, until June of 2020.

### **Current Financial Status**

CFSIC is statutorily insolvent.

CFSIC is on a July 1 through June 30 fiscal year. As of CFSIC's 7/31/19 unaudited financials, CFSIC carried a cumulative insolvency of (\$61,498,530). This means that CFSIC is underwater by that amount, and therefore is entirely dependent upon future revenues to offset existing claim liabilities that represent verifiable individual homeowner foundation impairment.

From the standpoint of available cash versus commitments to construction expense, general expense, and foundation replacement reimbursements, CFSIC maintains, as of the date of this writing, a positive cash balance.

CFSIC has accomplished this by rationing its available cash through restrictions imposed on the countersigning of homeowner Participation Agreements by the Superintendent. CFSIC currently has made \$34.9 million in construction and reimbursement commitments to its claimants, through the action of the Superintendent's countersigning of Participation Agreements, of which \$21.8 million are outstanding unpaid commitments, for which CFSIC has set aside cash in order to honor these homeowner promises.

CFSIC has gone into suspension twice since January 10 in order to ration its cash. It is currently, as of this writing, in suspension, which means that the Superintendent is not currently countersigning Participation Agreements. This results in a stoppage of the scheduling of future remediation, with a consequent slow-down of construction workflow and the slowing down of tax abatement remediation.

Booked unfunded claim liabilities greatly exceed CFSIC's cash balance. Booked liabilities consist of insurance company claim reserves, which are commitments to individual homeowners for remediation or reimbursement when cash becomes available, and as a result Participation Agreements can be signed with those homeowners. These reserves are substantiated by individual applications from homeowners accompanied by verifiable points of written and photographic evidence.

At all times, CFSIC must maintain a cash balance in excess of cash commitments to construction and reimbursement, in order to provide for unencumbered statutory capital and surplus of a minimum of \$225,000 and to provide for the payment of applicable operating expenses, in order to secure the flow of services so that if, at any point, further funding is not forthcoming, service providers can be terminated quickly and effectively,



CFSIC's license as an insurer surrendered, and its operations terminated. Should CFSIC's operations be terminated, CFSIC would go into receivership, coming under the direct control of the Connecticut Insurance Department.

## **Operations**

Operations began with the taking of applications at 9:00 AM on January 10, 2019. During the period April 27, 2018 to January 10, 2019, CFSIC was engaged in organizational matters, including the filing of its statutory business plan, the selection of outsourced service providers, the creation of its underwriting platform including its electronic application process, and other organization and development activities.

Initial delays in 2018 in receiving funds from state government significantly impeded CFSIC's planned launch and delayed its remediation activities. These delays also resulted in outsourced service providers, rendering services to CFSIC during its formation, not being paid for the first four-and-a-half months of CFSIC's operations. A subsequent additional delay in the receipt of the second part of the first bond allotment in the late fall of 2018 further delayed CFSIC's originally scheduled launch of operations in November of 2018. CFSIC was finally able to commence operations on January 10, 2019.

## **Expenses**

CFSIC's cost of operations includes the cost of claim adjustment, administrative services, legal services, actuarial services, accounting services, public outreach activities, audit fees, and insurance expense. CFSIC has no employees, as is traditional under the structure of a captive insurance company.

Its directors are volunteers who have agreed to contribute time to this effort as a public service.

CFSIC tracks its expenses on a calendar year basis, based on the advice of counsel with respect to the interpretation of the limitation contained in the original enabling legislation that CFSIC cannot expend more than 10% of all revenues received in any calendar year on administrative and operational expenses.

During the calendar year ending 2018, on a cash basis CFSIC's administrative and operational expenses were \$453,443, or 2.3% of funds received. On an accrual basis the number was \$504,534, or 2.5% of funds received.

During the calendar year 2019 (as of the date of this writing), on a cash basis CFSIC's administrative and operational expenses are \$686,248, or 3.4% of funds received. On an accrual basis the number is \$822,304, or 4.1% of funds received.

To date, on a cash basis, CFSIC's general and administrative expenses, inclusive of all expenses related to claim adjustment, has averaged 2.9%, and on an accrual basis 3.3%, expressed as an average percentage of total revenues received during the two calendar years in question.



**Claimant Activity; Booked Statutory Liability; Total Claim Payments to Date**

What follows provides information as to the extent of application activity, booked liability, and paid claim liability to date, valued as of 8/31/19:

Town	Total Active/Inactive Claimants Identified	Total Statutory Claim Liability Booked	Total Claim Payments to Date
Amston	1	\$175,000	\$131,250
Andover	6	979,878	12,240
Ashford	24	3,589,216	173,158
Berlin	1	0	0
Bloomfield	3	174,984	17,500
Bolton	15	1,608,016	74,512
Branford	1	0	0
Broad Brook	5	552,745	82,026
Burlington	1	0	0
Columbia	4	544,952	127,488
Coventry	48	5,787,761	1,100,204
Deep River	1	0	0
East Hartford	3	234,383	129,383
East Windsor	21	420,000	0
Eastford	1	40,956	30,717
Ellington	61	8,174,160	1,389,242
Enfield	18	2,411,808	212,855
Glastonbury	3	224,163	36,873
Granby	1	175,000	0
Hebron	3	479,885	135,740
Manchester	102	13,386,112	402,095
Mansfield	5	612,421	232,697
Middletown	1	0	0
Milford	1	0	0
Monroe	1	0	0
Naugatuck	2	0	0
New Britain	1	0	0
New Haven	2	0	0
Somers	18	1,910,941	157,500
South Windsor	91	13,283,649	1,663,018



Town	Total Active/Inactive Claimants Identified	Total Statutory Claim Liability Booked	Total Claim Payments to Date
Stafford/Stafford Springs	88	\$11,547,626	\$947,294
Storrs	8	1,066,099	26,221
Suffield	3	517,000	131,250
Tolland	134	19,793,405	3,495,668
Union	8	1,021,391	239,253
Vernon	332	21,938,068	969,321
Waterbury	1	0	0
West Hartford	1	0	0
West Haven	1	0	0
West Suffield	1	175,000	17,500
Willington	88	10,366,901	1,132,157
Woodstock	2	350,000	17,500
<b>TOTAL</b>	<b>1,112</b>	<b>\$121,541,521</b>	<b>\$13,084,661</b>

Commentary:

1. The data in the CFSIC program changes daily, in fact in some cases hourly. This data is valid as of close of business on August 31, 2019.
2. Estimates of booked liability by the end of August (which will not be reflected on CFSIC's financials until September 10) will be approximately \$121.5 million; paid liability is estimated to be \$13.1 million; and total claimant count to be approximately 1,112.
3. Under CFSIC's Underwriting and Claims Management Guidelines, it is possible to have a claimant registered where no current booked liability is reported for that claimant. This can be due to incomplete application information at the time the application is filed or due to lack of eligibility pending a change in individual claimant circumstances.
4. Both booked and paid claim liabilities are reflective of claim activity for Type 1 and Type 2 claimants.

**The Participation Agreement Process**

CFSIC holds Connecticut captive insurance license #29. Its charter and its operations are reflective of those of a licensed insurance company; however, CFSIC does not collect any premium and does not issue an insurance contract in the form of an insurance policy. As a result, CFSIC's operations resemble those of a captive insurer in some respects, and not at all in others.

What eventually binds CFSIC and an individual homeowner contractually is a Participation Agreement, which outlines both the homeowner's and CFSIC's responsibilities, payment schedules, and contractual commitments. Participation Agreements have been signed on a regular basis, permitting foundation remediation to



be scheduled, and foundation reimbursements to be made, for approximately the past five months, except on the two occasions during those five months when CFSIC has been in suspension, rationing its cash, and therefore temporarily stopping the process of Participation Agreement execution.

It is important to note that the actual schedule of remediation is up to the homeowner and the contractor in question in each case. When the Superintendent countersigns a Participation Agreement, this can literally mean that in some cases the remediation can commence in a few days, or in a few years, depending upon contractor and homeowner schedules. Once the Superintendent countersigns a Participation Agreement, CFSIC has in effect made a promise to make payment. It is for this reason that, even though CFSIC's sunset date is June 30, 2022, CFSIC will in essence be running off Participation Agreement commitments, to the extent it receives all of its funding, for at least four years after its sunset date.

As of August 31, 2019, the Superintendent had countersigned 246 Participation Agreements. At least 91 more were awaiting execution on that date subject to the lifting of the suspension, which will most probably occur on or about October 4, 2019. It is important to note that when the Participation Agreement suspension is lifted, the Superintendent will execute Participation Agreements, permitting foundation remediation and reimbursement amounting to almost \$12 million in expense. This will happen within approximately a week of CFSIC receiving its next anticipated allotment of \$20 million. This will mean that approximately only \$8 million in funds will be available to support the signing of further Participation Agreements between the middle of October and the end of June 2020, when we anticipate receiving approximately \$8.5 million from the homeowner insurance policy surcharge.

As a result, CFSIC will be further rationing its cash by greatly restricting Participation Agreement signing through the remainder of this fiscal year. This will continue to cause construction delays and will further result in setbacks to the progress made in the revitalization of the economy of the Northeast Corner of Connecticut.

### **Application Process**

CFSIC's Underwriting and Claims Management Guidelines permit two types of claim activity.

A "Type 1" claim is a claim requesting assistance with the replacement of a foundation verifiably determined to be impaired through evidence of the presence of reactive pyrrhotite in the original aggregate used in the concrete composing that foundation, and where the homeowner has made, through the completion of an application and the provision of points of evidence, a valid claim for payment of enumerated allowable costs.

There are three classes of severity class code employed to reflect the degree of foundation impairment. These class codes provide a basic prioritization for the use of funds, beginning with Severity Class Code 3, which is a code reflective of a severely impacted foundation.



A “Type 2” claim is a claim requesting assistance with reimbursement by CFSIC to a homeowner for the replacement of a foundation verifiably determined to have been impaired through evidence of the presence of reactive pyrrhotite in the original aggregate used in the concrete composing that foundation, but where that homeowner used personal resources to originally repair/replace such an impaired foundation prior to making application to CFSIC; and where the homeowner has subsequently made, through the completion of an application and the provision of points of evidence, a valid claim for reimbursement of enumerated allowable costs.

CFSIC’s Board of Directors has authorized a total of 100 such Type 2 paid claim reimbursements to be made during CFSIC’s statutory lifetime.

The application process gathers information for purposes of underwriting, claim prioritization, and eventual potential payment. On average, more than 100 pages of supporting documentation are collected with each application. The average time to process an application varies significantly, based on the ability and willingness of individual claimants to provide CFSIC with quantifiable and verifiable data, either at the precise point of application to the program or at some point thereafter. For applications where claimants are responsive and compliant with all information requests, the application triage process is rapid, as is evidenced by the fact that on January 10, 2019 CFSIC had \$0 in statutory booked claim liabilities, and as of August 31, 2019 carried \$121,541,521 in identified actual and eventually payable liabilities for Type 1 and Type 2 claimants.

### **Temporary Suspension of Application Activity**

Of the \$125,500,000 in expected revenue noted above, CFSIC can commit to total actual foundation remediation and reimbursement, from its inception to its sunset date, of \$121,675,000 during its expected statutory lifetime, the difference between these two numbers being general and administrative operations expense and the maintenance of minimum statutory capital.

On September 2, 2019, based on a calculation of the volume of claim activity recorded as of 8/31/19, we decided to announce, on September 3, that CFSIC would go into suspension for the taking of new applications on September 6 at 5:00 PM. As of this date, I can confirm that this has in fact happened.

Therefore, CFSIC is currently under two types of suspension: the first is a suspension of the signing of Participation Agreements (which we believe will end shortly), and the second is the suspension of the taking of new applications (which we believe may last 90 to 120 days).

### **CFSIC’s Direct Effect on the 40 Recorded Towns in the Affected Area**

CFSIC’s operations are having a direct and positive effect on the existing property tax abatement crisis in CT’s Northeast Corner.





The towns of Ashford, Coventry, Ellington, Manchester, Somers, South Windsor, Stafford, Tolland, Vernon, and Willington represent 92% of the total of the existing residential property tax abatements booked on the balance sheets of the towns in the Northeast Corner. Booked liabilities held by CFSIC for foundation remediation in those ten towns represent 90% of CFSIC's statutory balance sheet liabilities.

This means that in less than seven months, CFSIC has clearly identified homeowner claimants in the towns hardest hit by tax abatements, and these homeowners are in line for eventual assistance, thus enabling CFSIC to make a difference not only in people's lives, but also to the towns in which they live.

CFSIC has been, for the past seven months, improving the economies of the ten hardest hit communities, literally one home at a time, by identifying affected homes and beginning the process of restoring those homes, through foundation remediation, to original assessed value. By twelve months from the date of this writing we project that CFSIC will have restored as much as 45% of the total of the current tax abatements for residential dwellings in these top ten hardest hit Connecticut communities.

### **The Extent of the Crisis**

In the past seven months, CFSIC has collected a significant amount of data through the application and remediation processes. None of the data collected to date suggests that the crumbling foundations crisis currently affects as many as 35,000 homes in the 40 communities where CFSIC has applicants. Similarly, no data in CFSIC's possession provides evidence of a crisis of the magnitude of \$1 billion to \$2 billion, as has been widely reported.

However, the crumbling foundations crisis is a devastating economic and human crisis.

We believe that this crisis involves most probably approximately 5,000 homes in total, which will require remediation between the date of this writing and the end of 2029 in two distinct waves of remediation activity, as described below. To be clear, the negative economic impact on the communities and the citizens of the Northeast Corner of Connecticut is quantifiable, verifiable, and cannot be disputed.

It is important to emphasize what we firmly believe to be the manageable size of this crisis. We also believe that the key to raising additional funding from state and federal sources will in fact be the understanding of just how manageable this crisis is, through the adoption of realistic and verifiable assessments of the impact of the crisis.

CFSIC's database is the only credible database in existence on the extent of this crisis.

As a result of what CFSIC's data now suggests, we maintain that this crisis is now and will continue to be a crisis that is manageable in what we project is two potential "waves" of impairment manifestation: the first one that began on January 10, 2019 and will run through approximately June 30, 2024...and a second one, which will begin then and end at some point at the end of 2029, resulting in as many as 5,000 foundation replacements.





I would like to close by acknowledging that what we have achieved in the past seven months is as a result of a team effort.

About a dozen people work behind the scenes on the CFSIC project on a daily basis in one capacity or another. These people support the office of Superintendent by quietly doing a job each day that very few people would take on. These people are my teammates, and they recognize the terrible toll that this crisis has taken on people's lives. I'm proud of my teammates. They have acted patiently with victims whose lives have been turned upside down by this crisis.

The crumbling foundations crisis is a natural disaster. Evidence of the correctness of the word "natural" and equally of the word "disaster" has been verified by our data. Those who continue to doubt, doubt against verifiable statistics. My recommendation to the public, to state government, and to the new Superintendent, is to focus on what CFSIC has done in seven months and to build on that success.

Whether or not one believes that a captive insurance company should have been formed to address this crisis; whether or not one believes that CFSIC's mission is an appropriate use of taxpayer funds; whether or not one believes that the insurance companies who have denied these claims have a right to do so...CFSIC exists, despite any debate, and the evidence of its success is repeated, day by day, one home at a time, and is beyond dispute.

Respectfully submitted,

Michael Maglaras, Principal  
Michael Maglaras & Company, Superintendent of CFSIC

Sources of Data:

CFSIC August 31, 2019 Incurred Loss Run

CFSIC July 31, 2019 Unaudited Financials

CFSIC Internal Construction Tracking Data

March 27, 2019 Minutes: Town of Coventry Crumbling Foundations Meeting