Agenda Report

DATE: May 21, 2001

TO: CITY COUNCIL

FROM: CITY MANAGER

SUBJECT: Purchase of City Property Insurance for the period May 2001 - May 2002

RECOMMENDATIONS:

It is recommended that the City Council authorize the City Manager to purchase Property Insurance under a joint purchase program established by the City's Broker of Record, Robert F. Driver Company, Inc., at an annual premium not to exceed $641,721 for the term, May 15, 2001 to May 15, 2002.

Competitive bidding is not required pursuant to City Charter Section 1002(F) Contracts for Professional or Unique Services. Per City Council Resolution #4373, the purchase of insurance is exempt from the Affirmative Action in contracting ordinance.

BACKGROUND:

The annual renewal premium for the City's Property Insurance Program will be $641,720.10, an increase of $287,924.10 compared to last year's premium of $353,796.

The City purchases "All Risk" property insurance on all City properties and "Difference in Conditions" insurance (earthquake and flood) protection at specific locations. Historically, City Council policy has limited the purchase of earthquake insurance to those properties where bond indentures require it. (Bond indentures require earthquake coverage, but only if available at reasonable rates.) The current standard deductible is $5,000 for most perils. The deductible varies - examples include: 5% for earthquake; $100,000 for vehicle collision; and up to $100,000 for certain electrical apparatus. Policy limits remain at $1,000,000,000. Various sub-limits apply (including earthquake insurance at $7,500,000).

The City purchases insurance under the City's Broker of Record contract with Robert F. Driver Company, Inc., on property values of $736,139,300 (a book-evaluated value increase of $23,269,169 from last year). Current coverage was marketed to insurance underwriters under a joint purchase group program established by the City's broker. The program originally combined the purchasing power of more than one hundred and fifty California public agencies to provide rates below those available to individual members. The group is called the Public Entity Property Insurance Program (PEPIP). The insurance purchasing group has expanded to now include 2,800 public entities in 7 states with over $70,000,000,000 in insured values. The size and geographical diversity attracts underwriters with capacity to take risk without dependence on massive amounts of reinsurance. Carriers are rated at least A-:VII by Best's Key Rating Guide. The primary layer of $5,000,000 on All Risk (excluding California Earthquake) is fronted by Specialty Surplus Insurance Company, a Kemper Group Company, and covered by reinsurance. Claims will be processed through an independent claims adjusting company, Maxon & Young, with an adjuster working from the Broker's office in Newport Beach. There are approximately 40 different insurers from Europe, Bermuda, and the United States participating in the layers above primary and in California Earthquake.

There is no sharing of risk under this program, and each PEPIP Member is protected to the same extent as if separate policies had been written.

Earthquake coverage costs have sharply increased this year. The price and terms of earthquake coverage justifies historical City Council policy to forego purchase of earthquake coverage except where bonds demand such purchase. The bonds that require purchase of earthquake coverage are on: 1) Jackie Robinson Park and Center; 2) Villa Parke Community Center; 3) Fire Stations 31 and 33; 4) Holly Street Parking Structure; 5) Delacey Parking Structure; 6) Plaza Las Fuentes; and, 7) Central Library. The properties have a Real Property insured value of $136,482,356 (up in value from last year's $115,188,139). [In years prior to the soft insurance market, the City purchased a limit of $250,000,000 per location per occurrence on about $700,000,000 in insured property values. It is not unusual to buy insurance to cover expected loss rather than to pay premium to cover a loss that could only occur in theory.]

The increase in premiums is caused by world-wide rate increases for property insurance after 10 years of rate decreases followed by last year's small increase. Unlike past market hardening episodes which were driven by lack of capacity to underwrite risks due to catastrophic losses, this increase is more of a market correction; competing insurance companies reduced rates below the level where they could obtain a reasonable profit two years ago. Last year's increase returned the City to a net premium slightly below what City paid in the 1998-1999 policy year. This year's increase returns the City's premium to a rate charged in about 1996, although City has to look back to about 1990, before PEPIP was founded, to see similar net premium payments by the City of Pasadena.

The structure of this renewal is designed to preserve the form of PEPIP's coverage, which included many coverage concessions obtained in the soft market years. Among concessions the City will loose this year are: coverage for Increased Cost of Construction due to building code upgrades; coverage for damage caused to unscheduled roadways, highways, streets, sidewalks, culverts, streetlights and traffic signals in non-FEMA/OES declared emergencies; coverage for damage by computer viruses; and decrease of a few sub-limits on special coverages.

The potentially most bothersome change, which is still under negotiation with the underwriters, will require payment of additional premium of 120% in case of a loss where it is determined that replacement value of the damaged insured property has been understated by 20% or more; this is not as tough as a traditional co-insurance clause, but threatens the City's administrative protection wherein property overlooked in good faith by a Risk Manager will be covered, as well as City's ability to automatically cover acquired property without reporting it until the following year's renewal. [On October 31, 1993, a fire occurred in a Thyristor Valve at the Sylmar Converter Station. The City of Los Angeles administered the project, but did not buy insurance. The Cities of Glendale, Burbank and Pasadena own 10% of the Station, but all three omitted to schedule the property on the PEPIP property schedules. All three cities made claim against the PEPIP policies in effect at the time. This year, the three cities finally received payments from PEPIP on a settlement of about $1.2 million.

(Pasadena's recovery was $283,967.30.) The three cities did not add the location to PEPIP coverage so the underwriters could recover premium in future years, but separately insured the property in conjunction with the City of Los Angeles. It is likely that the proposed coverage change is a result of this claim.]

FISCAL IMPACT:

Funds for this insurance premium are budgeted in the General Liability Fund and will be charged back to departments' budget accounts as part of their General Liability rates.

Respectfully submitted,

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City Manager

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