

Agenda Report

July 16, 2012

TO: Honorable Mayor and City Council
FROM: Office of the City Attorney
SUBJECT: PURCHASE OF CITY PROPERTY INSURANCE FOR THE PERIOD JULY 1, 2012 – JUNE 30, 2013

RECOMMENDATION:

It is recommended that the City Council:

1. Authorize the City Manager to purchase property insurance under a joint public agency purchase program established by the City's broker of record, Alliant Insurance Services, Inc., at an annual premium of \$466,798, without competitive bidding, pursuant to City Charter Section 1002(H) (contracts with other governmental entities or their contractors), and without competitive selection, pursuant to Pasadena Municipal Code, Section 4.08.049(B) (best interests); and
2. Authorize the City Manager to purchase property insurance for the power plant at a projected annual premium of \$602,310.25 for the term July 1, 2012 to June 30, 2013. Competitive bidding is not required pursuant to City Charter Section 1002(F), Contracts for Professional or Unique Services; and
3. Grant the proposed contract an exemption from the competitive selection process of the Competitive Bidding and Purchasing Ordinance pursuant to Pasadena Municipal Code Section 4.08.049(B), contracts for which the City's best interests are served.

EXECUTIVE SUMMARY:

The City's liability insurance program includes policies for general property, power plant property, and excess liability. In October 2008, the City Council authorized a purchase of excess liability insurance with four annual renewals that would not require further City Council action provided the premium does not exceed \$400,000. The 2012/13 premium for the excess liability coverage is \$364,703.28, which is \$22,772 above this year's premium but below the \$400,000 authorized limit. The excess liability policy has already been renewed with the 2012/13 fiscal year. With this report, staff is requesting authorization to renew only the general property and power plant property policies.

The 2012/13 fiscal year premium for general property insurance through the Public Entity Property Insurance Program (PEPIP) is \$466,798. This is an increase of \$68,663 or 17.2 percent over the 2011/12 premium of \$398,135 due primarily to a combination of rate and insured value increases.

The 2012/13 premium to renew the current coverage for power plant property is \$602,310.25. This is a \$28,685.25, or 5 percent increase from last year's premium of \$573,625 due primarily to the fire loss experienced in 2010 and the age of the plant.

The purchase of insurance differs from the purchase of other goods and services in that insurance markets cannot be approached through the typical RFP practice of public entities. Typically, insurance markets respond best to a single insurance broker of record which represents an entity; however, selection of an insurance broker of record typically uses the standard RFP process. The City of Pasadena has contracted with Alliant Insurance Services, Inc. (Alliant Insurance Services) as the City's insurance broker of record with the exclusive right to access insurance markets worldwide on behalf of the City for the past 18 years.

Alliant Insurance Services created an insurance purchasing group to approach the markets and minimize the cost of insurance. The predevelopment process to receive municipal property liability insurance quotes is very lengthy. Insurance brokers typically need to begin working with insurance market engineers and underwriters in the fall to solicit and receive insurance quotes by June. Since the policies typically lapse June 30th, staff will always be in a position where renewal of coverage will need to be administratively bound by July 1st and ratified by City Council in the first weeks of July. The renewal proposals for the 2012/13 fiscal year were received June 12, 2012.

Although staff believes that the current broker has provided a good service, after a recently completed staff review of the liability insurance program and consistent with industry best practices, staff believes that broker of record services should be bid for the 2013/14 fiscal year. Given the timeline necessary for the insurance market quote process, it is staff's intent to release an RFP for broker of record services no later than early September 2012 so that a broker can be selected and approved by City Council in mid to late October 2012.

BACKGROUND:

General Property

Pasadena is part of the Public Entity Property Insurance Program (PEPIP) which provides insurance for general property. PEPIP is a joint insurance purchasing group created by the City's insurance broker of record, Alliant Insurance Services. It is the largest single property insurance placement agency in the world and was formed in 1993 to meet the unique property insurance needs faced by public entities. It provides limits up to \$1 billion per member. The City of Pasadena is an original member and has remained in the program since its inception. Each municipality is underwritten on its own merits and does not share risk with others; however, the benefit of the program includes lower premiums due to volume purchasing. The group has expanded to include 2,800 public entities in seven states with over \$70 billion of insured values. The size and geographical diversity attracts underwriters with capacity to take risk without dependence on massive amounts of reinsurance. Participating insurers must be rated at least A-:VII by *Best's Key Rating Guide*. There are eighteen insurance companies or insurance facilities participating in this year's program.

The first \$25 million layer of the PEPIP insurance program is underwritten by Lexington Insurance of London, an AIG owned company. Catastrophic losses in the insurance market over the past three years have caused the market to tighten which accounts for 7 to 10 percent of the rate increase. For the 2012/13 fiscal year, the rate per \$100 of valuation increased from \$0.0488008 to \$0.0545906, an increase of 11.86 percent. The basic all-risk property deductible is \$25,000. Other deductibles vary based on the specific type of item insured. All risk property policy limits remain at \$1 billion on insurable values now totaling \$855,088,405.

The 2012/13 fiscal year premium for general property insurance through PEPIP is \$466,798. This is an increase of \$68,663 or 17.2 percent over the 2011/12 premium of \$398,135.

Another reason for the premium increase is that the total insured values increased from \$815,836,619 to \$855,088,405 due to inflation on building materials which are used to estimate replacement cost values.

Power Plant Property

As reported last year, the PEP program no longer insures power plant property due to the increased risk exposure. Consequently, Pasadena had to purchase free standing coverage. Unfortunately, Pasadena had a large fire loss at its power plant on May 4, 2010. This event, combined with the age of the plant, resulted in premium quotes of \$1 million and higher last year, which required a restructuring of the coverage to reduce the premium. Even with the reduced coverage structure, only one insurer, Lloyds of London, was willing to underwrite the Pasadena power plant risk, with the requirement that the coverage value of the older turbines and boilers would only be 15 percent of the replacement cost. This is the same coverage and insurer recommended for the 2012/13 fiscal year.

The 2012/13 premium to renew the current coverage for power plant property is \$602,310.25. This is an increase of \$28,685.25 or 5 percent from last year's premium of \$573,625.

Staff asked the insurance broker of record to solicit quotes for various options and the premium impact. The options ranged from increasing the current \$250,000 deductible to \$500,000 or \$1 million and/or changing the insurable values. The quotes for these options ranged from an annual premium low of \$432,934 for coverage that would exclude unit B3 and raise the deductible to \$1 million to an annual premium high of \$611,712 that would include an increase in the replacement cost cap to 20 percent for the GT2 unit (B3 unit would remain capped at 15 percent of replacement cost) with a deductible of \$250,000. Staff believes that maintaining the same coverage structure as 2011/12 and reviewing and revising the coverage structure for the 2013/14 is the most prudent action at this time.

Summary of Options Reviewed

Last year staff conducted a review of the insurance program to identify options which could be implemented to minimize insurance costs, particularly for the power plant given the large year-over-year increase for the 2011/12 fiscal year.

The options reviewed are discussed below.

Change Insurance Broker of Record

Alliant Insurance Services has been Pasadena's exclusive broker of record since May 1, 1994, and had brokered insurance programs for Pasadena prior to that. Entities that wish to purchase insurance traditionally approach markets by granting exclusive authority to a single broker. The use of multiple brokers runs the risk of insurers not providing a bid due to the potential of the insurer bidding against itself. The City's current broker of

record provides services at a flat \$44,000 per year as opposed to a commission based on the amount of insurance, which could be considerably more expensive. Given the length of time that Pasadena has contracted with the current broker, staff believes that it is prudent to bid out the service to ensure the program meets industry standards and is as efficient as possible. Unfortunately, the review was completed after the time considered necessary to complete an effective process for property insurance quotes for the 2012/13 fiscal year. Consequently, staff plans to solicit bids for these services in September 2012 and bring a recommendation to City Council in mid to late October. This plan will provide sufficient time for the broker of record to perform the due diligence necessary to receive competitive quotes from insurance providers for the 2013/14 fiscal year.

Cancel and Remarket

Generally insurance policies can be cancelled with only a prorated amount due upon cancellation; however, Pasadena received only one quote out of the fourteen insurance markets approached for the power plant, which is our largest policy. It is unlikely at this time that any market will change its mind and give Pasadena a better quote. Last year Pasadena had to restructure the coverage and increase the deductible for the power plant property to receive a quote that was below \$1 million per year. It is believed that more interaction and marketing between the City's insurance broker of record and the insurance markets might provide a better result in the future.

Increase Deductible

The City could increase its deductible. This option means that Pasadena would self-insure losses at the power plant per incident up to the deductible amount. As discussed above, quotes were received for various options for the power plant properties which included increasing the deductibles up to \$1 million. Other public entities carry various deductible levels to protect older plants while keeping premiums as low as possible; however, given the history of the City's recent loss combined with an existing identical unit and the need for a more formal analysis by the insurance broker of record, it is recommended that this option be considered as a part of the 2013/14 insurance process.

Self-insurance on Certain Property

Self-insurance equates to not having insurance to offset any of the loss risk for City property. This option is not recommended because it exposes the City to risks that could impact the City's financial stability. Additionally, insurance is a requirement of the various bond issues which are supported

by revenues produced by City property such as the power plant.

Future Insurance Market Observations

Indications are that primary insurers are offering less capacity and surplus lines insurers are being asked for quotes at a lower coverage level than in past years. Fewer risks are being taken by insurance companies because investment income is down. Therefore, high risk coverage, such as on power plants, is not undertaken as readily as in past years. It is expected that the market will be worse next year with higher premiums. This will require extra effort in the marketing of City property to demonstrate a lower risk. Additional coverage restructuring may still be necessary if the markets continue to tighten.

COUNCIL POLICY CONSIDERATION:

The City Council's strategic planning goals of maintaining fiscal responsibility and stability and improving, maintaining, and enhancing public facilities and infrastructure will be advanced through the procurement of property insurance.

FISCAL IMPACT:

The cost of this action will be \$1,069,108.25. Funding for this action will be addressed by various city-wide existing appropriations in account number 8031. It is anticipated that all costs will be spent during the current fiscal year.

Respectfully submitted,


MICHELE BEAL BAGNERIS
City Attorney

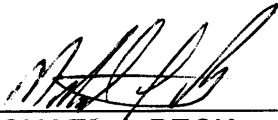
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