



Memorandum

TO: TREATMENT PLANT ADVISORY
COMMITTEE

FROM: Julia H. Cooper

SUBJECT: SEE BELOW

DATE: September 1, 2020

Approved

Date

9/3/2020

**SUBJECT: RECOMMENDATION TO THE CITY COUNCIL ON INSURANCE
RENEWALS FOR SAN JOSÉ – SANTA CLARA REGIONAL
WASTEWATER FACILITY**

RECOMMENDATION

Recommend that the City Council authorize the Director of Finance to:

- (a) Select and purchase City property and liability insurance policies for the Regional Wastewater Facility for the period October 1, 2020 to October 1, 2021, at a total cost not to exceed \$273,434 as well as an 18.0% contingency for additional property or assets scheduled, subject to the appropriation of funds with the following insurance carriers:
 - (1) Factory Mutual Insurance Company for Property Insurance, including Boiler & Machinery and TRIA Coverage;
 - (2) Beazley Syndicate 2623/623 at Lloyd's for Terrorism Insurance;
 - (3) Axis Surplus Insurance Company and RSUI Indemnity Company for \$15 million in excess flood insurance for locations in high and moderate hazard flood zones on a 50/50 quota share basis; and
 - (4) Gemini Insurance Company for Auto Liability Insurance for the vehicle fleets at the Regional Wastewater Facility.

OUTCOME

Approval of this recommendation will ensure the Regional Wastewater Facility ("RWF") maintains appropriate insurance coverage to provide financial protection from certain types of catastrophic or financial loss.

BACKGROUND

Each year, the City purchases insurance to protect against a catastrophic event or specified perils. This decision is based on many factors including but not limited to, when the frequency of events cannot be predicted, the severity of potential loss could seriously hamper operations, and when the cost of the insurance policy is not prohibitive.

Insurance coverage for the Regional Wastewater Facility is part of a larger pool of assets covered under the City's insurance program. Bundling assets creates a strategic advantage, allowing for economies of scale and spread of risk exposure which results in a lower overall cost of insurance for all facilities under the policies, including the RWF. The RWF is a beneficiary of this strategy, as purchasing standalone insurance policies, particularly in the current commercial insurance market environment, would be more difficult to secure and result in less coverage at a higher cost.

To secure policies, the Finance Department annually reviews the City's insurance coverage and needs with the City's insurance broker, Arthur J. Gallagher Insurance Services ("Gallagher"). This includes analyzing the City's risk exposures, trends in the insurance markets, product availability, and the City's historical approach to insuring for losses. Gallagher presents the City's risk portfolio to insurance carriers to obtain the best value insurance coverage, solicits competitive quotations from major insurance companies for all recommended products, and presents the results to the Finance Department for consideration.

Staff compares and evaluates the quotes based on scope of coverage, cost, the insurer's financial strength and reputation for paying claims, and the insurer's availability of resources to provide industry-related services such as property evaluations, safety training, and loss prevention engineering services. Based on the information and analysis, the Finance Department determines the appropriate insurance coverage and makes a recommendation on the most advantageous insurance policies.

ANALYSIS

The Finance Department has completed the annual insurance renewal process for FY 2020-2021 with Gallagher and recommends the insurance coverage described below. This memorandum covers the insurance programs that apply to the Regional Wastewater Facility. Staff will be taking its complete set of recommendation for the Citywide insurance program to City Council for approval on September 22, 2020.

In the current annual insurance renewal cycle, changes in market conditions affecting all commercial policyholders, the City's exposure to natural catastrophes (flood), and its loss history contributed to negative/unfavorable changes in the renewal pricing and terms for property insurance.

A. Insurance Coverage Recommended

1. All Risk Property including Boiler & Machinery Insurance

Provides coverage for City-owned and leased real and personal property (including buildings, contents, business interruption, boiler and machinery, electronic data processing equipment and media, fine arts, loss of rents, expediting expenses, off premises services interruption, unnamed locations, transit, animals, accounts receivable, valuable papers, data, rebuild with green upgrades, and other coverage as detailed in the policy forms subject to sub-limits as defined in the policy).

The Regional Wastewater Facility is part of the City's larger insurance program for property coverage. This structure creates economics of scale, allowing the RWF to be insured at a competitive premium and be provided coverage that would be otherwise unattainable if separately insured.

The market for commercial property insurance has continued to harden since the City's last annual renewal. Insurers are focused on profitability and policyholders with catastrophe exposure and a history of losses are seeing rate increases excess of 30%¹.

Staff reviews the property values in the City's overall property schedule prior to annual renewal to adjust values up or down to reflect current and future conditions as appropriate. Overall, property values increased this year, which is in part attributed to an increased in \$100.2 million in insured values for capital projects at the RWF that will reach substantial completion during the policy period.

The City's incumbent property insurer Factory Mutual ("FM") proposed the most competitive program for this term. The property insurance limit quoted by FM is \$1.0 billion each occurrence with a \$100,000 deductible per occurrence. For locations not in high and moderate hazard flood zones, the City has additional coverage for the loss peril of flood with annual aggregate limits of \$100 million and a \$500,000 per location deductible. For locations in high and moderate hazard flood zones such as the RWF, the FM proposal includes annual aggregate limits of \$10 million. Gallagher has confirmed that the option from FM is the best available to the City from a cost and coverage standpoint.

A summary of key changes relative to the expiring program is provided below.

- Premium increase for the RWF of \$67,109, or 50.29% from the previous fiscal year renewal due to the increase in rates as well as the increase in insured values at the RWF

¹ Willis Towers Watson North America Market Conditions Summer 2020 Update (August 2020)

- Reduction in policy limits available for business interruption citywide from \$1.0 billion to \$300.0 million
- Reduction in policy limits available for Communicable Disease Response and Interruption by Communicable Disease coverage citywide from \$1.0M to \$10,000
- Reduction in policy limits available to cover the cost of replacement power at the RWF should the cogeneration facility experience a covered property loss from \$1.0 billion to \$11.0 million with the RWF being provided an option to exclude this coverage for a \$41,500 premium reduction

In addition to the insurance products procured last year, the City utilized risk engineering services to evaluate properties. Risk engineering services help identify common risks resulting in damage or destruction of property such as fire, flood, or other operational risks and are geared to finding solutions aimed to reduce property loss or disruption of use. A visit scheduled for the RWF was cancelled due to the COVID-19 pandemic. At the recommendation of FM, the City will be enhancing flood emergency response plans at the RWF.

Insurance Carrier: Factory Mutual Insurance Company

Annual Premium (Net):	\$ 177,419 ²
Broker Fees:	<u>5,530³</u>
Total Annual Costs:	\$ 182,949

2. Terrorism Risk Insurance Act of 2002 (TRIA) and Terrorism Insurance

Terrorism Risk Insurance Act (“TRIA”) coverage provides an insurance mechanism (shared by private insurance carriers and the federal government) for losses arising from acts of terrorism as certified by the Secretary of the U.S. Treasury and defined by the TRIA. It does not cover liability. Coverage is currently provided through a temporary federal program for 85% of total aggregate loss up to \$100 billion in aggregate losses with total losses being no less than \$5 million. The cost of purchasing TRIA coverage is fully incorporated into the product cost analysis above, except for the All Risk Property Insurance program where FM has provided a quote for an incremental premium of \$49,142, a 47.11% increase over the expiring premium.

The City began purchasing stand-alone terrorism in 2019. Stand-alone terrorism insurance provides a broader definition of terrorism than TRIA and includes third party liability coverage. Staff is recommending continuation of a combined property and liability policy. Beazley provided a renewal quote for \$10 million in aggregate limits for a premium of \$17,734, a 4.26% increase over the expiring premium.

² Annual Premium represents the RWF allocation for the Citywide property premiums.

³ Broker fees include fees for TRIA, Stand-alone Terrorism and Excess Flood coverages

Insurance Carrier: Factory Mutual Insurance Company (TRIA)
Annual Premium: \$ 4,401⁴ (Net)

Insurance Carrier: Beazley Syndicate 2623/623 at Lloyd's
Annual Premium: \$ 1,588⁵ (Net)

3. Excess Flood Insurance

To mitigate the impact of reduction to the base flood coverage from \$25,000,000 to \$10,000,000, the City obtained an excess policy for locations in high and moderate hazard flood zones. The excess policy provides \$15,000,000 in limits excess of the primary property policy on a 50/50 quota share basis, where the City and excess insurers share the financing of losses on a 50/50 basis.

Insurance Carrier: Axis Surplus Insurance Company and RSUI Indemnity Company
Annual Premium: \$ 17,152⁶ (Net)

4. Automobile Liability for Regional Wastewater Facility (RWF) Fleet

Automobile liability provides stand-alone coverage for bodily injury, property damage and personal injury for claims arising out of vehicle operation at the RWF.

Adverse market conditions and the RWF recent claims history led to a 54.62% increase in premiums and fees in 2019. Additionally, the RWF increased its per occurrence retention for the auto liability insurance coverage from \$0 to \$250,000. This year, the RWF auto liability program experienced a more modest 9.34% increase in premium and fees driven primarily by an 8.77% increase in the vehicle count at the facility.

Insurance Carrier: Gemini Insurance Company

Annual Premium:	\$62,843 (Net)
Surplus Lines Tax:	<u>2,042</u>
Total Annual Premium:	\$64,885
Broker Fees:	<u>2,459</u>
Total Annual Cost:	\$67,344

⁴ Annual Premium represents the RWF allocation for the Citywide TRIA premiums

⁵ Annual Premium represents the RWF allocation for the Citywide stand-alone terrorism premiums

⁶ Annual Premium represents the RWF allocation for the Citywide excess flood premiums and fees

B. Insurance Coverage Not Recommended

The insurance coverage listed below was again reviewed by staff with the assistance of Gallagher. The market conditions remain consistent with last year's renewal decisions. Staff does not recommend purchasing additional coverage now. The recommendation is based on multiple factors including but not limited to: the products being cost prohibitive; the scope of coverage being too narrow considering the City's risk exposure; or that the coverage was unavailable, limits too low, or excessive in cost due to the nature of the risk. Staff, in consultation with Gallagher, will continue to review the market on a periodic basis and make the appropriate recommendations to Council should circumstances change.

1. Earthquake

Earthquake coverage is provided through a separate insurance product line. Coverage is limited to direct damages caused by earth movement, which is excluded on the All Risk Property coverage policy. Coverage for sprinkler damage and fire resulting from an earthquake is covered by the All Risk Property policy. In previous years, staff has inquired into the total cost of earthquake insurance for the entire property schedule and found coverage to be cost prohibitive.

The City's broker confirmed rates have not improved for FY 2020-2021, and market conditions have deteriorated year-over-year. The insurance markets that underwrite catastrophic coverage (flood, wind, and earthquake) have reduced available capacity along with increasing insurance rates. This pricing level, the minimum deductible of 5% of the values at risk, the relatively low limits of coverage available, and potential concerns about solvency of the insurers make it uneconomical to purchase coverage for the RWF.

CONCLUSION

Approval of this recommendation will ensure the RWF maintains appropriate property and casualty insurance coverage to provide financial protection from certain types of catastrophic or financial losses.

EVALUATION AND FOLLOW-UP

The memorandum will not require any follow-up from staff.

CLIMATE SMART SAN JOSE

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

COORDINATION

This memo has been coordinated with the Environmental Services Department as well as the City Manager’s Budget Office and the City Attorney’s Office.

COMMISSION RECOMMENDATION/INPUT

This item is scheduled to be heard at the September 10, 2020 Treatment Plant Advisory Committee meeting.

COST SUMMARY/IMPLICATIONS

The estimated funding to pay for various insurance premiums in 2020-2021 was included in the 2020-2021 Adopted Operating Budget approved by the City Council on June 16, 2020. The recommend action includes authorization for an 18.0% contingency to schedule additional property or assets as required.

BUDGET REFERENCE

The table below identifies the fund and appropriations recommended to fund the insurance premiums identified.

Fund #	Appn #	Appn. Name	Total Appn.	Amount for Premium ^a	2020-2021 Proposed Budget Page ^b	Last Budget Action (Date, Ord. No.)
513	0762	Non-Personal/Equipment (Environmental Services Department)	\$34,680,552	\$273,434	IX-87	06/23/2020 30437

^a The amount for premium is subject to change up until the beginning date of the new insurance policy. Therefore, current estimates are lower than the recommended contract amount.

^b The 2020-2021 Adopted Operating Budget was approved by City Council on June 16, 2020 and the Annual Appropriation Ordinance and Funding Sources Resolution implementing the 2020-2021 Operating and Capital Budgets were adopted on June 23, 2020.

Treatment Plant Advisory Committee Board

September 1, 2020

Subject: Approval of Insurance Renewals for San José – Santa Clara Regional Wastewater Facility

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CEQA

Not a Project, File No. PP17-003, Agreements/Contracts (New or Amended) resulting in no physical changes to the environment.

/s/

JULIA H. COOPER

Director of Finance

For questions, please contact Miguel Bernal, Risk Manager, at (408) 975-1438.

APPENDIX A

1. ALL RISK PROPERTY AND BOILER & MACHINERY INSURANCE

	CURRENT PROGRAM	RENEWAL PROGRAM
	10/01/2019-10/01/2020	10/01/2020-10/01/2021
Carrier	Factory Mutual Insurance Company (FM)	Factory Mutual Insurance Company (FM)
Limit of Liability	\$1,000,000,000 subject to a	\$1,000,000,000 subject to a
	\$100,000 Deductible Per Occurrence	\$100,000 Deductible Per Occurrence
Boiler & Machinery	Included	Included
Earthquake	Excluded. Relatively low limits available 5% deductible, high premium-not recommended.	Excluded. Relatively low limits available 5% deductible, high premium-not recommended.
Flood	\$100,000,000 but not to exceed \$25,000,000 in high and moderate exposed hazard flood zones, deductible is \$100,000 per location of loss except for locations in high and moderate exposure flood zones. Deductible is \$500,000 per location for locations in high and moderate exposed flood zones except the Airport, Convention Center, and RWF are given a flat \$10M (Airport & Convention Center) and \$5M (RWF) per location flood deductible.	\$100,000,000 but not to exceed \$25,000,000 in high and moderate exposed hazard flood zones, deductible is \$100,000 per location of loss except for locations in high and moderate exposure flood zones. Deductible is \$500,000 per location for locations in high and moderate exposed flood zones except the Airport, Convention Center, and RWF are given a flat \$10M (Airport & Convention Center) and \$5M (RWF) per location flood deductible.
Other Sub-limits	Other sub-limits as outlined in the insurance policy on file with Risk Management	Other sub-limits as outlined in the insurance policy on file with Risk Management
Terrorism and Non-Certified Act of Terrorism	Included for additional premium	Included for additional premium
Engineering Services	Included in coverage	Included in coverage
Multiyear	Not Available	Not Available

2. AUTOMOBILE LIABILITY-RWF FLEET

	CURRENT PROGRAM 10/01/2019-10/01/2020	RENEWAL PROGRAM 10/01/2020-10/01/2021
Carrier	Gemini Insurance Company (Auto Liability)	Gemini Insurance Company (Auto Liability)
Coverage	Auto Liability-Fleet Only \$1,000,000 Combined Single Limit (Any Auto) Retention \$250,000 each Accident	Auto Liability-Fleet Only \$1,000,000 Combined Single Limit (Any Auto) Retention \$250,000 each Accident
Exposure	Number of Units 57	Number of Units 62
Average Rate Per Unit	\$1,041.05	\$1,086.19
Annual Premium	\$57,970	\$62,843
Surplus Lines Taxes & Fees	\$1,370	\$2,042
Broker Fees	\$0	\$2,459
Total (Including Taxes/Fees)	\$59,340	\$67,344