



Memorandum

TO: TREATMENT PLANT ADVISORY
COMMITTEE

FROM: Julia H. Cooper

SUBJECT: SEE BELOW

DATE: August 26, 2022

Approved

Date

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

RECOMMENDATION

Recommend 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, 2022 to October 1, 2023, at a total cost not to exceed \$524,899 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 Terrorism Risk Insurance Act Coverage;
 - (2) Beazley Syndicate 2623/623 at Lloyd's for Terrorism Insurance;
 - (3) Arch Specialty Insurance Company and The Princeton Excess and Surplus Lines Insurance 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, where the severity of potential loss could seriously hamper operations, and when the cost of the insurance policy is not prohibitive.

Insurance coverage for the RWF is part of a larger pool of assets covered under the City's insurance program. While unbundling the RWF property exposure from the citywide program may introduce new carriers that are unable to underwrite a \$5.5 billion property 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 benefits from being marketed along with other City occupancies that are considered lower risk. As a standalone account, the RWF would be underwritten by a different property insurance marketplace because of the power generating exposure arising from the Cogeneration Facility, making it more difficult to secure adequate property insurance and result in less coverage at a higher cost.

To secure policies, the Finance Department reviews the City insurance coverage and needs with the City insurance broker, Alliant Insurance Services (Alliant). This review includes analyzing the City's risk exposures, trends in the insurance markets, product line availability, and the City's historical approach to insuring for losses. Alliant 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 insurance product lines, 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 claims payment, and the insurer's availability of resources to provide services such as property evaluations, safety training, and loss prevention engineering services. Based on the received 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 2022-2023 with Alliant 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 recommendations for the Citywide insurance program to City Council for approval on September 20, 2022.

In the current annual insurance renewal cycle, commercial insurance policyholders continue to face challenging market conditions as global commercial insurance prices rose 9% in the second

quarter of 2022, the nineteenth consecutive quarter in which composite pricing rose. The pace of rate increases slowed for the sixth consecutive quarter since increases peaked at 22% in the fourth quarter of 2020¹. Inflationary conditions also have had an impact both in terms of increasing insurer loss costs and increasing the valuation of assets used to produce a schedule of values used for property insurance underwriting, which have affected the RWF's renewal results.

A. Insurance Coverage Recommended

1. All Risk Property including Boiler & Machinery Insurance

The All Risk property 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 market for commercial property insurance has moderated since the City's last annual renewal. Valuation of assets was the marquee issue for property insurance buyers this year due to construction cost inflation. Premium increases for most policyholders are being driven more by inflation raising insurable values than by increases in rate¹.

As recommended in September 21, 2021 memorandum to the Treatment Plant Advisory Committee², staff solicited and obtained a property appraisal of the site to update the replacement cost values of buildings and equipment in May 2022. As a result of the appraisal, reported insurable values at the RWF increased by 87.25% year-over-year from \$398.0 million to \$745.3 million.

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. The FM proposal includes annual aggregate limits of \$10 million for flood that apply to all City locations. Alliant has confirmed the option from FM is the best available to the City from a cost and coverage standpoint.

¹ https://www.marsh.com/uk/services/international-placement-services/insights/global_insurance_market_index.html

² <https://www.sanjoseca.gov/home/showdocument?id=76804>

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

- Premium increase for the RWF of \$155,315, or 76.3% from the previous fiscal year renewal due primarily to the increase in insurable values at the RWF and mitigated by two one-time premium credits the City received in the FM proposal.
- The cyber coverage’s territory has been updated to exclude property located in Russia, Ukraine, Luhansk People’s Republic, and Donetsk People’s Republic. Since the change is linked to property damage in the excluded coverage territories, staff does not anticipate any adverse impact to the RWF.
- Expediting Costs and Extra Expense combined limits will be reduced from \$100 million to \$10 million.
- The base coverage for flood was reduced to \$10 million across all locations citywide. Previously, the City had \$100 million in flood coverage for locations considered to be in low hazard flood zones. This change has no impact to the RWF as it has been subject to \$10 million in base flood coverage since 2019.

To mitigate the impact of the increases in premium, FM provided two options to achieve premium savings citywide by increasing the minimum deductible of \$100,000 to either \$250,000 or \$500,000. Staff recommends increasing the minimum deductible from \$100,000 to \$500,000 to achieve annualized premium savings of \$303,209 citywide, and a premium credit of \$41,101 to the RWF.

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. FM will be conducting its annual visit to the RWF in November, 2022.

Insurance Carrier: Factory Mutual Insurance Company

Policy Period	2022-2023	2021-2022
Annual Premium (Net) ³	\$317,741	\$203,527
Broker Fees ⁴	\$4,893	\$5,295
Total Annual Costs	\$322,634	\$208,822

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 Treasury, in consultation with the Secretary of Homeland Security and Attorney General, and defined by the TRIA. It does not cover

³ Annual Premium represents the RWF allocation for the Citywide property premiums.

⁴ Broker fees include fees for TRIA, Stand-alone Terrorism and Excess Flood coverages

liability losses. Coverage is currently provided through a federal program for 85% of total aggregate loss up to \$100 billion in aggregate losses with total losses being no less than \$5 million. FM has provided a quote for TRIA coverage for an incremental premium of \$16,767, an \$8,637 or 106.25% increase over the expiring premium. Drivers for the increase include the increase in insurable values and a rate increase on the TRIA coverage. FM indicated that the higher rate reflects the fact that a large portion of the citywide insurable values (such as the Norman Y. Mineta San José International Airport, the McEnery Convention Center, and the SAP Center) are considered targets for a terrorism loss.

The City began purchasing stand-alone terrorism insurance in 2019. Stand-alone terrorism insurance provides a broader definition of terrorism than TRIA, does not require certification by the federal government, and includes third party liability coverage. Staff is recommending continuation of a combined property and liability terrorism policy. Beazley provided a renewal quote for \$10 million in aggregate limits for a premium and fees of \$3,300, a \$1,649 or 100.19% increase over the expiring premium.

Insurance Carrier: Factory Mutual Insurance Company (TRIA)

Policy Period	2022-2023	2021-2022
Annual Premium (Net)	\$16,767	\$8,129

Insurance Carrier: Beazley Syndicate 2623/623 at Lloyd’s

Policy Period	2022-2023	2021-2022
Annual Premium (Net)	\$3,300	\$1,649

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 has obtained excess flood coverage since 2019. The excess flood policy provides \$15,000,000 in limits excess of flood coverage in 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 Carriers: Arch Specialty Insurance Company and The Princeton Excess and Surplus Lines Insurance Company

Policy Period	2022-2023	2021-2022
Annual Premium (Net) + Surplus Lines Tax	\$33,537	\$16,257

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.

Despite a reduction in the RWF’s vehicle count, annual premiums, taxes, and fees are up \$10,226 or 7.54% over the expiring premiums, taxes, and fees. There is a limited marketplace for standalone public entity auto liability coverage. Alliant approached four (4) carriers and only the incumbent carrier offered a quote.

Insurance Carrier: Gemini Insurance Company

Policy Period	2022-2023	2021-2022
Annual Premium (Net)	\$141,185	\$131,281
Surplus Lines Tax	\$4,588	\$4,267
Total Annual Premiums	\$145,773	\$135,547
Broker Fees	\$2,889	\$1,721
Total Annual Costs	\$148,662	\$137,269

B. Insurance Coverage Not Recommended

The insurance coverage listed below was reviewed by staff with the assistance of Alliant. 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 following: 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 Alliant, 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 2022-2023, and market conditions have deteriorated slightly 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 citywide or 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.

COST SUMMARY/IMPLICATIONS

The estimated funding to pay for various insurance premiums in 2022-2023 was included in the 2022-2023 Adopted Operating Budget approved by the City Council on June 14, 2022 and adopted on June 21, 2022. The recommended 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	2022-2023 Proposed Budget Page ^b	Last Budget Action (Date, Ord. No.)
513	0762	Non-Personal/Equipment (Environmental Services Department)	\$37,280,941	\$524,899	927	06/21/2022 30790

^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 2022-2023 Adopted Operating Budget was approved by City Council on June 14, 2022 and the Annual Appropriation Ordinance and Funding Sources Resolution implementing the 2022-2023 Operating and Capital Budgets were adopted on June 21, 2022.

CEQA

Not a Project, File No. PP 10-066 (a) Agreements and Contracts for purchase of insurance.

/s/
JULIA H. COOPER
Director of Finance

For questions, please contact Miguel Bernal, Risk Manager, at miguel.bernal@sanjoseca.gov or (408) 975-1438.

APPENDIX A

1. ALL RISK PROPERTY AND BOILER & MACHINERY INSURANCE

	CURRENT PROGRAM	RENEWAL PROGRAM
	10/01/2021-10/01/2022	10/01/2022-10/01/2023
Carrier	Factory Mutual Insurance Company (FM)	Factory Mutual Insurance Company (FM)
RWF Total Insured Values	\$398,040,379	\$745,332,706
Limit of Liability	\$1,000,000,000 Property Damage and \$300,000,000 Business Interruption subject to a	\$1,000,000,000 Property Damage and \$300,000,000 Business Interruption subject to a
	\$100,000 Deductible Per Occurrence	\$500,000 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	\$10,000,000 annual aggregate, except \$100,000,000 annual aggregate for low 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.	\$10,000,000 annual aggregate, 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 all locations except the Airport, Convention Center, and RWF are given a flat \$10M (Airport & Convention Center) and \$5M (RWF) per location flood deductible.
Excess Flood	\$15,000,000 in excess limits on a 50/50 quota share basis for high and moderate flood exposed City locations.	\$15,000,000 in excess limits on a 50/50 quota share basis for all City locations.
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 10/01/2021-10/01/2022	RENEWAL PROGRAM 10/01/2022-10/01/2023
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: 55
Average Rate Per Unit	\$2,448.18	\$2,702.95