Office of Superintendent of Schools
Board Meeting of October 11, 2006

October 4, 2006

Business Operations
Ofelia San Pedro, Deputy Superintendent

SUBJECT: **REQUEST FOR AUTHORIZATION TO IMPLEMENT A PORTFOLIO BUILDER'S RISK INSURANCE PROGRAM FOR NEW AND EXISTING FACILITIES AS PART OF THE DISTRICT'S CAPITAL CONSTRUCTION PLAN**

COMMITTEE: **INNOVATION, EFFICIENCY & GOVERNMENTAL REALTIONS**

The Office of Risk and Benefits Management works closely with the Office of Facilities Management to determine insurance requirements for contractors who are building new schools and renovating existing facilities. In addition to determining coverage requirements, including recommended limits and deductible levels, risk management staff also works closely with facilities staff to document required coverages as being inforce, and participates in negotiations with contractors to determine the extent of reimbursement due to these required coverages.

Of the coverages required of contractors, including workers' compensation, general liability, automobile liability and builder's risk coverage (property insurance), the ability to secure adequate builder's risk coverage for construction projects has become a significant challenge for general contractors. As is being experienced by the Board for its property insurance program, contractors are experiencing significant cost increases due to the lack of available capacity in the marketplace for windstorm coverage in catastrophic prone areas such as South Florida.

The district's master property insurance program is not designed to cover district property under construction. Therefore, the district's ability to guarantee that adequate property insurance coverage is in place for new construction and existing facilities under construction (including additions and renovations) is crucial.

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Since Hurricane Andrew in 1992, the contractors have been required to secure builder's risk insurance coverage with required limits of coverage in the amount of the awarded construction project. The cost of this coverage is passed on to the district and has increased significantly as the marketplace for windstorm coverage in South Florida has skyrocketed. Additionally, because of the property insurance crisis in the State of Florida affecting windstorm deductibles, some negotiations with contractors on large projects have resulted in the Board having to retain substantial amounts of the windstorm deductibles in addition to absorbing the cost of the coverage for the contractor.

The district has developed a very strategic relationship over the past several years with various property insurance markets to continue to have access to their limits and capacity. Lexington Insurance Company (AIG) which provides $21,175,000 part of the $200 million in the district's current property insurance placement is a very big writer of individual builder's risk policies for contractors in South Florida. Over the past six months, the availability of this coverage has deteriorated and the costs have continued to escalate.

In an effort to identify solutions to this property insurance crisis which is affecting everyone in the State of Florida, staff began talks with Lexington Insurance Company regarding the ability to construct a program in Miami-Dade County similar to a master builder's risk program which is currently in place in Palm Beach County. Following discussions with the lead property underwriter for Lexington Insurance Company, staff from the Office of Risk and Benefits Management and Facilities Operations met with a group of contractors currently providing services to the district to obtain their input regarding the creation of such a program. Because of the difficulty in obtaining individual coverage, the contractors were very supportive of the district's idea to create this master (portfolio) program and felt that the creation of such a program with a more strategic approach to obtaining coverage limits would result in savings to the district's capital budget.

The State of Florida Department of Education has recognized that service requirements for insurance are sometimes such that negotiations, rather than bidding are appropriate. Pursuant to the provisions of State Board Rule 6A-1.1.012(11), district school boards may purchase insurance and risk management programs by direct negotiation and contract. The Board's insurance consulting firm of Siver Insurance Consultants, Inc. has provided a written recommendation supporting the district's approach in negotiating a builder's risk program with Lexington Insurance Company through Arthur J. Gallagher & Co. because of the existing relationships which exist, and the lack of available coverage options due to the windstorm insurance crisis.

Portfolio Builder's Risk Program Features and Benefits

- 3-year annual rate per $100/of payments for construction projects
- Broad coverage terms
- Consistent uniform coverage and deductibles for all School Board projects
- Reasonable deductibles for windstorm and all other perils
- Determination of reasonable amount of coverage to be carried by district
- Access to Federal Emergency Management Agency (FEMA) as a backstop
- Significant savings to the capital budget
- Exempt from Surplus Lines Tax (5.2%) when policy is procured by owner
- Ability purchase a non-cancellable program at confirmed rates for 3 years

Example of Current Rates for Builder's Risk/Construction Values

As previously stated, the School Board currently pays for the cost of the contractor's builder's risk insurance policy as a direct reimbursement item. In order to determine the cost effectiveness of having the Board purchase the coverage directly, it is necessary to identify what the cost presently is for purchasing full value coverage versus purchasing what is a reasonable amount, taking into consideration the risk of loss potential. The following projects and associated costs were paid by the district for the contractor to purchase full limits of coverage, where available, and in some instances having the Board assume liability for the deductibles:

- Coverage with $50,000,000 limits was purchased for three middle school projects (MM-1, UU-1 and PP-1 – total values of $99,000,000) for premium of $5,746,000.

- Coverage with $50,000,000 limits was purchased for one high school (JJJ – total values of $75,665,488) for premium of $4,251,673.

- Average rate per $100 of values is $5.72.

Lexington Insurance Company provided two options of coverage for the Portfolio Builder's Risk Program consisting of all risk, replacement cost coverage for buildings under construction with limits of liability of $50,000,000 per occurrence subject to Named Windstorm sublimits of $25,000,000 per occurrence/$50,000,000 annual aggregate, based upon a 3-year policy term.

The due diligence required to ascertain whether the proposed limits are adequate requires a risk analysis of exposures in place versus past claims history. Currently, staff believes that the amount of builder's risk coverage which is being procured exceeds the expected risk to the district. While it was the safest method to follow when property coverage was readily available, assumptions now must be made as to the balance of how much to procure versus the cost, not unlike the exercise which is undertaken when placing the district's master property insurance program for existing facilities.

Based upon the lack of claims emanating from the past two prolific hurricane seasons, as well as a lack of claims for other perils such as fire, vandalism, etc., staff believes that the proposed limits of $50,000,000 per occurrence subject to Named Windstorm sublimits of $25,000,000 per occurrence/$50,000,000 annual aggregate are sufficient to adequately protect the district's exposure. The ability to access public assistance money through FEMA in the event of a catastrophic loss which would exceed the district's cover is an added feature which does not exist in the current structure of having the contractors procure their own coverage at the district's expense.

The two options offered by Lexington differ with regards to the Named Storm Deductible which applies and are reflected below:

Option	I	II
Named Storm Limit	$25M/$50M	$25M/$50M
Named Storm Deductible	5%/$10M min. per occ. Deductible	$5%/$25M min. per occ. Deductible
All Other Peril Deductible	$50,000 Per occurrence	$50,000 Per occurrence
Rate/$100 Annual Expenditures		
New Capacity	$1.28	$0.998
Non-New Capacity	$0.685	$0.557

Annual expenditures in 2006-2007 fiscal year of 5-Year Capital Plan:

New Capacity:	$856,838,931
Other than New Capacity:	$222,209,888
Total Annual Expenditures	$1,079,048,819

The deposit premium for 2006-2007 will be based on 50% of total annual expenditures, or $539,524,409 (50% of $1,079,048,810).

Based upon a review of the two options, including the cost of the coverage, and the determination of the probability of risk, staff is recommending Option II, inclusive of the per occurrence minimum Named Storm deductible of $25,000,000. In addition to having a significant rate decrease for that deductible, as compared to the other option, this program would now align with the structure of the district's master property insurance program for its existing facilities which also has a per occurrence minimum deductible of $25,000,000.

Taking the figures from the Board's five year capital plan, the cost of this program is based upon $1,079,000,000 of new construction contracts being awarded over the next 12 months. With this base in mind, and comparing the cost of the recommended builder's risk program with average premiums based upon recently placed projects , estimates of savings for the next 3 years are as follows:

	Estimated Builder's Risk Premium for Contractor-provided Coverage	Estimated Portfolio Builder's Risk Premium Option II	Estimated Savings
2006-2007	$41,000,000	$8,021,944	$32,978,056
2007-2008	$38,000,000	$4,635,012	$33,364,988
2008-2009	$22,000,000	$2,923,162	$19,076,838
Est. 3-Year Savings	$101,000,000	$15,580,118	$85,419,882

[Savings estimates include estimated premiums for projects with total values over $10,000,000 and do not include applicable taxes or assessments. Limits and deductibles are different in the above estimated programs.]

Based upon the information contained within Agenda Item E-14, Adoption of Five-Year Facilities work Program Required by s.1013.35, Florida Statutes, staff is aware that the capital budget has adequate funds for capital construction projects awarded in fiscal year 2006-2007, but runs short of cash beginning in fiscal year 2007-2008 and beyond. For purposes of representing this builder's risk program to the Board, the cost comparison assumes adequate funding for project awarded after 7-1-07 and beyond. Premiums are paid as deposits of expected construction projects on an annual basis, and are firmed up annually within 60 days of the end of each policy year to compare actual versus anticipated construction values to produce a final audited premium. This same process will occur annually while the program is in place, resulting in the Board only paying for property insurance coverage for projects which are placed under contract for construction.

There are a few options which the underwriter has made available to increase available limits and expand available coverages. These options, with staff's recommendations are presented below:

Option #1 Interior Water Damage Extension

The basic program includes $1,000,000 per occurrence for damage resulting from interior water damage, subject to per occurrence deductible of $100,000. The basis for this coverage is to cover losses to interior finishes, etc. as a result of water damage. The underwriter has offered to increase the base $1,000,000 limit to $2,500,000 for a 5% surcharge to the rate, or a limit increase to $5,000,000 for a 7.5% surcharge to the rate.

Staff is recommending an increase to the limits for interior water damage from $1,000,000 to $2,500,000 for the premium surcharge of 5%.

Option #2

The basic deductible for perils other than named windstorm (all other perils AOP) is $50,000. The underwriter has offered an option to increase the AOP deductible to $500,000 for a premium credit of $333,804 or an increase in the AOP deductible to $1,000,000, for a premium credit of $455,212. This would also result in an increase in the deductible for the recommended interior water damage peril, which is based at $100,000 per occurrence. In addition, each option for a premium credit will also provide a credit in the State of Florida Citizens Assessment.

Staff is recommending that the AOP deductible remain at $50,000, thereby rejecting option #2. The premium credit for a significant increase in this deductible was not material, and staff believes that before this recommendation could be made, additional information on current smaller losses occurring at construction sites needs to be obtained. As part of the Board's contract with its contractors, staff is recommending that this $50,000 deductible be borne by the contractor.

Option #3

The underwriter has provided a quotation for Terrorism coverage, pursuant to the Federal Terrorism Relief Insurance Act (TRIA) for a flat annual premium of $165,000. Staff is recommending purchase of terrorism (TRIA) coverage.

Option #4

The basic program provides a 3-year policy, subject to annual deposit premiums with minimum earned of 50% of the first year premium (deposit premiums based upon 50% of estimated expenditures, subject to cancellation provisions). The underwriter is providing an option which makes the policy non-cancellable by either party, with the exception of non-payment of premiums, with the minimum earned premium being increased from 50% of the first year premium to 50% of the three year premiums.

The value of entering into a non-cancellable policy is that the Board will have secured windstorm capacity for this program for a three year period, regardless of status of the property insurance marketplace over that period of time. With the market in such turmoil, and premiums continuing to rise, with available capacity deteriorating, the prospect of having a guaranteed program for three years is very attractive. The downside of this offer is if the Board would not be able to financially sustain its capital construction program into its second and third years. If this were the case, and the Board did not meet 50% of the estimated expenditures for that policy year, which is what the deposit premium is based upon.

Being that the deposit premiums are based upon 50% of annual expenditures, staff believes that the risk of possibly losing deposit premium is outweighed by the ability to secure dedicated property insurance capacity for the next three years. This ability to lock in the capacity and rates will provide an ability to lock in property insurance costs, including windstorm coverage, which will provide stability to the district's capital plan's expenditures.

When the Board approved the final structure for its master property insurance program which provides all risk, replacement cost property insurance coverage for existing facilities, the Board was informed that a 6.84% assessment had been levied against all insurers and insureds in the State of Florida for deficits incurred in Citizen's Property Insurance Corporation (Citizen's), the state created insurer of last resort.

This assessment, which is currently being paid by the Board as part of the reimbursable property insurance costs to its contractors, and will be charged to the Board in addition to premium costs for the recommended Portfolio Builder's Risk Program.

RECOMMENDED: That The School Board of Miami-Dade County, Florida:

1. purchase a Portfolio Builder's Risk Insurance Program consisting of all risk, replacement cost, property insurance coverage for facilities under construction as part of the district's Five Year Capital Plan from Lexington Insurance Company (A.M. Best A+ XV), through Arthur J. Gallagher & Co., effective October 12, 2006, for a three year term, with limits of coverage of $50,000,000 per occurrence subject to Named Windstrom sublimits of $25,000,000 per occurrence/$50,000,000 policy annual aggregate, subject to a Named Windstorm deductible of 5% of affected values per location/$25,000,000 minimum per loss deductible, and a per loss deductible of $50,000 for perils other than those subject to the Named Windstorm deductible, and limits for interior water damage of $2,500,000, subject to a per occurrence deductible of $100,000, with premium rates of $1.0479/$100 of annual expenditures for new capacity construction and $0.5849/$100 of annual expenditures for other than new capacity construction, subject to annual audit of actual expenditures for policy years 2006-2007; 2007-2008; and 2008-2009, inclusive of a non-cancellable clause for the three year term, with 50% of the three year term premium being due and payable if the Board were to cancel the policy;

2. authorize payment of the State of Florida Citizen's Property Insurance Corporation required assessment (currently 6.84%, subject to change) and any other required assessments or fees for premiums due for the Portfolio Builder's Risk Insurance Program for the three year policy term;

3. amend its construction contracts and documents to reflect the existence of the district's Portfolio Builder's Risk Insurance Program, including the creation of a per loss deductible of $50,000, regardless of the peril to be borne by the contractor:

4. authorize insurance consulting fees to be paid to the Board's insurance consulting firm of Siver Insurance Consultants, Inc. to assist in modifying existing standard district construction contracts, review issued policies and premium billings, and provide other required professional services and advise on the district's Portfolio Builder's Risk Insurance Program with consulting fees of $150/hour, with annual expenditures not to exceed $50,000 per policy year; and

5. authorize all payments, including deposit and audit premiums and applicable consulting expenses to be paid from the Board's Capital Outlay Budget for fiscal years 2006-2007, 2007-2008; and 2008-2009.

OSP:sc