THE REGENTS OF THE UNIVERSITY OF CALIFORNIA

ANALYSIS OF THE MASTER BUILDER'S RISK INSURANCE PROGRAM

Prepared By:

Cindy Low, ARM
Office of the President
Office of Risk Services

Updated: February 18, 2009

Requirement to Secure Builder's Risk Insurance

There is no government code or legislative statute which mandates Builder's risk insurance to be maintained on all University construction projects. There is also no Regental policy specific to Builder's risk insurance. However, it is construction industry standard for either a project owner or the contractor to procure this insurance to cover property damaged in the course of construction by perils not caused by the contractor's negligence. While the contractor ultimately is responsible for the project until completion, it is in the University's best interest to secure Builder's risk insurance to avoid substantial financial loss from the risk being uninsured.

While there is no Regental policy that mandates a systemwide Builder's risk insurance program, as long as there is one in force, the Facilities Manual requires that all construction projects in excess of $200,000 must obtain coverage under the University's Master Builder's Risk insurance program.

Builder's Risk Insurance Provided by the Contractor or by the University

There is no University policy which prohibits the contractor from providing Builder's risk insurance. Prior to September 1989, when the University's Master Builder's Risk insurance program was implemented, the contract documents stipulated that the contractor would provide this insurance. Whether the risk is insured by the contractor or the University, the cost is borne by the University. If the contractor insures the risk, the premium cost plus profit margin (which may also include independent agent and broker commissions) is passed back to the University in the project cost.

Implementation of a Master Builder's Risk Insurance Program

Sometime prior to September 1989, there were concerns relating to the increased cost of construction, of which insurance was a component, and this became a topic of discussion with the Vice Chancellors. The issue was brought to the Office of Risk Management for review. An analysis was conducted to determine the feasibility of the University securing the insurance rather than the contractor. It was determined that a master program in which the University secures the insurance would provide not only cost savings, but also a number of other benefits to the University. The idea of the program was discussed amongst various University personnel at all UC locations, including Vice Chancellors, Associate Vice Chancellors, Directors, and those involved in review of the University's construction contracts. A business decision was made to implement a master program. This decision was made through the collaborative efforts of both Facilities and Risk Management at Office of the President.

Benefits to a Master Builder's Risk Insurance Program

- Premium Savings

  Due to economies of scale, the University's leverage with the insurance carriers we do business with for other lines of coverage, and the volume of capital projects throughout the UC system, a favorable rate can be secured.

  Further savings can be achieved through the elimination of the profit margin, which can include independent agent and broker commissions that contractors can add to the project cost.

A master program will minimize the variable costs for Builder's risk related to each contractor's experience, volume, and surcharge in profit and overhead.

The master program may provide sublimits which are higher than what the contractor normally secures. For a contractor to secure higher sublimits would result in an additional premium that would be charged back to the University.

• <u>Limits Sufficient to Cover the Project</u>

Limits are dedicated to each University project versus contractor-provided coverage where the limits are shared with the contractor's other projects.

The University's program includes sublimits to cover additional components (e.g., transit, off-site storage, expediting expenses, etc.) which contractor-provided coverage may not have at the same limits or at all.

• <u>Control and Continuity over Policy Terms and Conditions</u>.

The University can negotiate the policy terms and conditions and secure coverage which best protects the interests of the University.

Contractor-provided coverage will subject the University to whatever coverage a contractor is able to or chooses to secure, which may be more restrictive. If UC relies on the contractor's Builder's Risk and that contractor is replaced during the term of the project, this will result in issues with continuity of coverage for the project.

• <u>Uniformity of Coverage and Rates</u>

With a master program, all projects have the same coverage and rates. With contractor-provided coverage, terms and conditions can vary from project to project and the smaller contractors may not have as much leverage to secure broad coverage. The rates will vary from contractor to contractor and the smaller contractors may be subject to higher rates.

Coverage continues with no disruption in the event that a contractor is replaced or defaults prior to completion of the project. Insurance companies are reluctant to insure a project in which some of the work has already been completed by another contractor.

For multiple prime contractors working on the same project, a master program will cover all prime contractors, which enables having uniform coverage throughout the project.

Uniformity of coverage eliminates the potential for any gaps or deficiencies in coverage. A situation in which this would be an issue is when the University procures equipment or materials for a contractor to install.

With uniformity of coverage also comes uniformity of claims adjusting. Unlike contractor-provided coverage where each contractor's insurance will have its own designated claims adjusting company and claims reporting protocol.

With the master program providing uniformity of coverage and claims adjusting, this eliminates the potential for increased evaluation and administration time incurred by the project management team.

• Acceptance of All Projects and Contractors of Every Tier

This eliminates the potential for a contractor or sub-contractor being unable to secure coverage or having coverage cancelled.

• No Lapse in Coverage when Builder's Risk Insurance is Terminated

Having the University secure coverage enables the Office of Risk Services to have immediate knowledge when Builder's risk insurance is terminated. This is critical because upon termination of Builder's risk insurance, the completed building becomes insured under University's property program and there may be reporting requirements in order for coverage to be afforded.

Comparison of Rates as of 09-01-2008

The Master Builder's Risk program was renewed September 1, 2008 at very competitive rates that are lower than in prior years. A comparison of the current rates against expired rates as well other contractors are reflected in the following table. Contractor names are confidential and are identified only as 1 and 2. We have compared the UC rates against other large national contractors.

Rates are per $100 of construction value.

Type of Construction	UC - Expired Rate	UC - Current Rate	Contractor 1	Contractor 2
Concrete/Steel Fire Resistive	$0.07	$0.0536	$0.06	$0.070
Wood Frame	$0.58	$0.315	$0.325	$0.40
Joisted Masonry	$0.221	$0.168	$0.225	$0.20

While the UC rates may not be substantially lower than those of other contractors, as shown above, there are other costs that are included in the contractor's premium cost that is passed back to the University. (Note: The above rates are representative of a random sampling of some of the top 100 contractors in the nation. Other contractors that do not fall into that category or do not have the volume of construction will have higher rates than those listed above.)

Nearly 80% of the University's construction falls into the category of Concrete/Steel Fire Resistive. In addition, the following table displays the statistical outlay of the mean and median project size during the University's most recent policy term (9/1/05–9/1/08). These values illustrate the University's predominant average construction contract size and may indicate that the University's frequency of awarding contracts may be to a pool of contractors who do not fall within the criteria of the top 100 contractors in the nation and, therefore, are not able to qualify for the low rates shown above, due to their lower annual construction volume.

Construction Value	# of Projects	Mean Value	Median Value
Under $10M	415	$1,664,524	$756,715
Over $ 10M -$100M	90	$35,375,745	$28,999,126

Comparison of Coverage as of 09-01-2008

Some of the major differences in UC coverage versus contractor-provided coverage:

- Industry standard practice excludes coverage for Interior Water Damage. The University's Master Builder's Risk insurance program has $15 million in coverage for this peril.
- The University's program has increased sublimits which contractors may not be able to obtain, such as off-site storage or transit in which our program has a $5 million sublimit for each.
- The deductible amount varies by contractor and can range from $25,000 to $250,000 per occurrence. The University's current policy has a $25,000 deductible for all covered perils.

Exposure versus Premium versus Losses

The premiums may seem significant except when compared to the exposures (construction value). But as reflected in the following table, incurred losses can and have exceeded the total premium paid during a policy term.

Policy Term	Construction Value	Premium	Incurred Losses	# Claims	Loss Ratio
9/1/98-01	$Not Available	$3,080,391	$1,418,256 (valued 10.16.08)	11	46%
9/1/01–05	$3,548,525,000	$6,224,169	$10,333,980 (valued 9.24.08)	54	166%
9/1/05-08	$2,832,545,820*	$4,354,401*	$268,070 (valued 9.24.08)	7	6%

* 9/1/05–08 figures are as of 11/11/2008 and encompass 474 individual projects of which 194 are still in progress, therefore, losses have not fully developed for this policy term.

Builder's Risk is a Systemwide UC Program

The insurance carrier evaluates the risk from a systemwide perspective and takes into account all projects throughout the UC system. The University's agreement with the insurance carrier is that we will place all Builder's risk insurance with them for projects valued from $200,000 up to $125,000,000 except wood frame projects which have a limit of $10,000,000**. UC's program is underwritten based upon that agreement along with the insurance carrier's commitment to rates and coverage terms based upon the volume and type of anticipated construction throughout the UC system. Each project or UC location is not evaluated and rated individually. The program provides coverage for projects from inception through completion. To change the agreement would require a global decision which could ultimately impact the rates.

** Projects in excess of $125,000,000 or excess $10,000,000 for wood frame are outside the Master Builder's Risk insurance program and require separate underwriting in which UC's broker will solicit quotes from various carriers to secure the most competitive program for that project.

Feasibility of Self-Insurance

Under the University's construction contract documents, the contractor is responsible for providing a substantially completed project in accordance with contract documents as determined by the University. This places the contractor at risk for any losses that may occur during the course of construction regardless of negligence. It is highly unlikely that any contractor would choose to risk financial loss by not insuring this exposure.

If the University were to take on the responsibility for this exposure and elect to self-insure, the source of funding would be the construction project budgets. While projects may be able to absorb small losses, they will not be able to withstand a catastrophic loss, which could result in substantial financial loss to the University with entire projects being either terminated and left incomplete or severely delayed due to lack of funds.

Recommendation

Construction risks are both much greater and different than risks associated with a fully constructed and occupied building; for this reason, the University's property insurance program does not provide coverage for property under the course of construction. It is critical to secure Builder's Risk insurance, which is the mechanism for insuring construction risks. As reflected in the "Exposure versus Premium versus Losses" table shown above, the exposure is far greater than the premium. Because of the potential for financial loss, construction risks are not risks that any contractor or the University would want to be uninsured for.

Based on the benefits and comparisons shown above, the Master Builder's Risk insurance program continues to best serve the interest of the University. The Office of the President, Office of Risk Services recommends the continuation of the Master Builder's Risk insurance program.

2-18-2009