Chairperson and Committee Members
AUDIT AND RISK COMMITTEE

30 NOVEMBER 2017

Meeting Status: **Public**

Purpose of Report: For Information

COUNCIL'S INSURANCE PROGRAMME FOR 2017-18

PURPOSE OF REPORT

1 The purpose of this report is to provide the Committee with a high level overview of the Council's main insurance cover for 2017/18.

DELEGATION

2 The Audit and Risk Committee has delegated authority to consider this report under the following delegation in the Governance Structure, Section B.3.

ensure that the Council has in place a current and comprehensive risk management framework and to make recommendations to the Council on risk mitigation.

BACKGROUND

3 The Kāpiti Coast District Council, together with Porirua, Hutt and Upper Hutt City Councils (collectively known as the Outer Wellington Shared Services Insurance Group or OWSS) has been purchasing insurance for their respective assets on a combined basis since 2009. This syndicate was necessary to provide the OWSS with scalability to the benefit of accessing wider domestic and off-shore insurers.

4 Greater Wellington Regional Council (GWRC) self-insures any losses from natural catastrophe to their infrastructure assets. However, in July 2016, GWRC joined the OWSS to insure their above ground assets through the collective. For insurance purposes only, the OWSS Councils and GWRC are collectively known as the Wellington Councils Insurance Group (WCIG).

5 As part of WCIG, the Kāpiti Coast District Council benefits from the expertise and resources made available to it through Aon Insurance Brokers (Aon). For example, this includes extensive asset loss modelling, insurance risk profiling and insurance placements with off-shore insurers.

6 Following several years of reducing insurance premiums, the insurance market has shown signs of tightening. As recommended by Aon, WCIG executed a Long Term Agreement (LTA) for both infrastructure assets (below ground) and above ground assets that secured insurance rates for two years from 1 October 2016 to 1 October 2018.

7 The magnitude 7.8 Kaikoura earthquake event that occurred on the 14 November 2016 was significant with multiple aftershocks continuing across surrounding areas. The Kāpiti Coast District Council did not suffer losses to its infrastructure and above ground assets and did not submit any loss claims to Aon for processing.

8 The WCIG has worked closely with Aon to secure insurance cover for the period 1 October 2017 to 1 October 2018. This was particularly challenging given the significant limitations now imposed on the Wellington insurance market by New Zealand Insurers:

- Wellington property insurance has incurred the highest increases in premiums ranging from 35% to 200%.
- LTA rates for wellington property insurance are being removed.
- Capped earthquake deductibles (i.e. 5% of the property sum insured capped at $20 million) are being removed by some insurers.
- Insurers are now moving to technical rates (higher rates driven by insurers own loss modelling results. Technical rates are often higher due to lack of specialised, localised knowledge).
- Lack of insurer capacity for either new risks and/or increases in sum insured values.

9 Offshore insurers have continued to offer insurance cover for Wellington properties at premium increases ranging from 10% to 15% because of large losses suffered from New Zealand catastrophes over the past six years. However, some offshore insurance syndicates are now reviewing their New Zealand insurance risk exposure and challenging the National Building Standards in light of the modern property failures in Wellington from the Kaikoura earthquake.

10 It is not economically possible to fully protect the Council against all losses from unforeseen events. Instead, for affordability, the Council best manages its risk exposure by ensuring it has sufficient insurance cover in place.

HIGH LEVEL OVERVIEW OF MAIN INSURANCE COVER

11 The Kāpiti Coast District Council's two most significant types of insurance cover include:

- natural catastrophe damage to infrastructure assets; and
- material damage and business interruption to above ground assets.

<u>Natural Catastrophe Damage to Infrastructure Assets</u>

12 Collectively, the OWSS Group has a sum insured value of $2.86 billion for infrastructure assets. The sum insured value represents the full replacement costs of these assets. Whilst the full replacement cost considers technological advances in construction methods and materials, it assumes no changes in the current levels of service. The Kāpiti Coast District Council's infrastructure assets have a sum insured value of $505 million.

13 Following extensive loss modelling and analysis, Aon has best estimated that an extreme earthquake event for the WCIG would be a magnitude 7.5 event on the Wellington fault that would likely result in a probable maximum loss (PML) of $635 million across the Wellington Region (excluding GWRC infrastructure assets). Whilst the majority of these losses are expected to occur in the Hutt Valley, losses of up to $30.20 million are estimated to occur across the Kāpiti District.

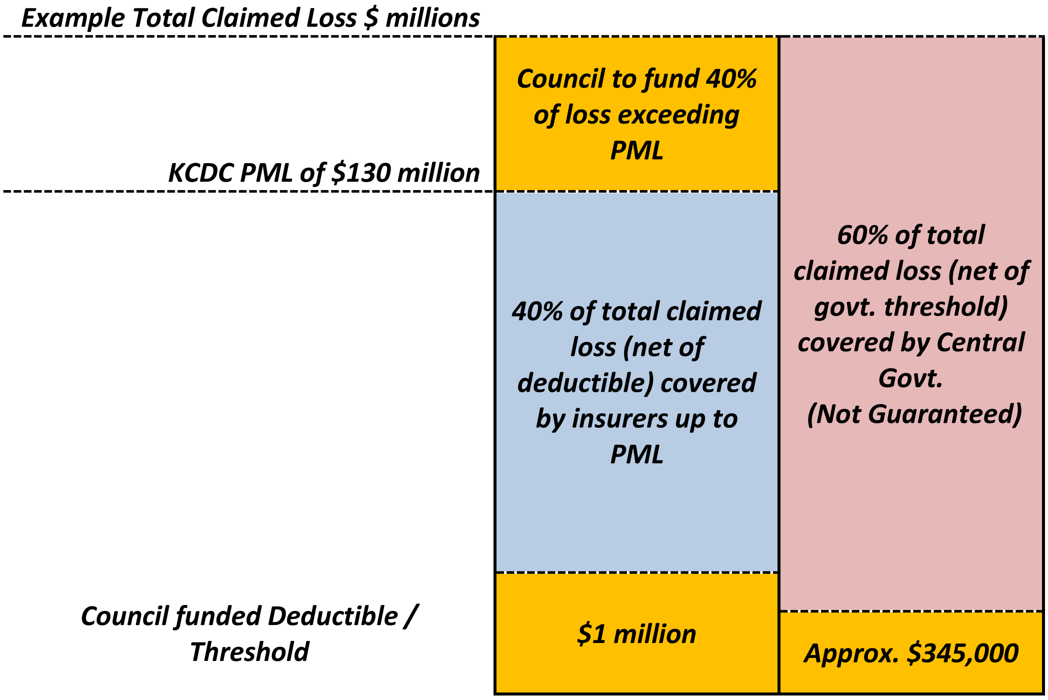
14 Aon extended this loss modelling and best estimated that an extreme earthquake event for the Kāpiti Coast District would be a magnitude 7.4 event caused by a rupture of the Ohariu fault and would be centred in Paraparaumu. This would likely result in a PML of $130 million for the Kāpiti Coast District Council.

15 Consequently, the OWSS has purchased natural catastrophe to infrastructure assets insurance cover with a Group Limit of $598 million (previously $600 million) for the period 1 October 2017 to 1 October 2018. This includes maximum insurance cover of $130 million for the Kāpiti Coast District Council, with a $1 million deductible per claim per event.

16 Note that 100% of the OWSS natural catastrophe damage to infrastructure assets insurance is provided from offshore insurers. The slightly lower Group Limit is due to Aon not being able to find additional insurance capacity on the $100m x $500m insurance layer (the final layer of insurance cover that is called on after $500 million of insurance capital has been utilised for claim settlements).

17 Central government currently support local government by way of a 60/40 funding split for damage caused to infrastructure assets from natural catastrophe. This means that for each qualifying event, total insured losses suffered by the Kāpiti Coast District Council that exceed a threshold of 0.0075% of the District's Net Rateable Value, will be 60% funded by central government. At the time of writing this report, the central government threshold for the Kāpiti District was approximately $345,000, based on the rateable land value of the Districtwide General Rate, net of rural zone differentials.

18 The residual risks of natural catastrophe damage to infrastructure assets are managed by insurance. This means that for each qualifying event, total insured losses suffered by the Kāpiti Coast District Council that exceed a threshold of $1 million, will be 40% funded from the OWSS insurers, up to the PML of $130 million. Up to 40% of losses exceeding the PML will need to be fully funded by the Kāpiti Coast District Council. This is explained by way of a diagram and examples below:



<u>Material Damage and Business Interruption to Above Ground Assets</u>

19 The WCIG has a total sum insured value of $1.54 billion of above ground assets. Unlike natural catastrophe damage to infrastructure assets, the sum insured value provides for the estimated cost of replacement to the same levels of service <u>and</u> additional costs due to business interruption.

20 From their loss modelling analysis, Aon has best estimated that a region-wide maximum credible earthquake event could result in material damages of up to $550 million (excluding business interruption) across the Wellington Region. Accordingly, the WCIG has purchased material damage and business interruption insurance cover with a combined Group Limit of $600 million. This includes a sum insured value of $230 million for the Kāpiti Coast District Council's above ground assets.

21 Note that the WCIG material damage and business interruption to above ground asset insurance cover is provided via the following split of 50/50 from New Zealand Insurers and offshore insurers respectively. Aon has successfully increased offshore insurer coverage by 10% for the period 1 October 2017 to 1 October 2018. This has partly mitigated some of the insurance market limitations imposed on the Wellington market.

22 The WCIG premium for the 12 months ended 1 October 2018 suffered an overall rate increase of 27.5%, driven by limitations placed on the Wellington insurance market and changes in sum insured values across the WCIG following above ground asset revaluations by Kāpiti Coast District Council and Porirua City Council.

23 Losses suffered to above ground assets that are not caused by natural catastrophe trigger a deductible of $50,000 per claim per event. This means that losses below $50,000 will need to be fully funded by the Kāpiti Coast District Council.

24 Losses suffered to above ground assets by natural catastrophes trigger a deductible of 5% of the site sum insured, with a minimum Group deductible of $100,000 (capped at $20 million) per claim per event. For example, the Coastlands Aquatic Centre has a sum insured value of $21 million. This means that in the event of a natural catastrophe loss to the facility, the Kāpiti Coast District Council will need to fund the first $1.05 million of the total insured loss before claiming from the insurers. Any losses in excess of the $230 million in aggregate will need to be fully funded by the Kāpiti Coast District Council.

ACTIONS TO REDUCE FINANCIAL RISKS

<u>Self-Insurance Fund</u>

25 Clearly, the Kāpiti Coast District Council is exposed to potentially significant financial risk in the event of losses caused by a natural catastrophe. Whilst the Council cannot anticipate these loss events, it can however plan to mitigate its financial risk exposure to uninsured losses by way of a self-insurance fund.

26 A rates-funded contingency fund of $150,000 is being established across 2017/18 as per Council agreement. Similarly, a contingency fund of $250,000 for asset replacement/s, to be funded from new borrowings if required, has also been provided for in the 2017/18 Annual Plan.

<u>Complete Regular Loss Modelling, Insurance Valuations, Risk Profiling and a Resilience Strategy</u>

27 To ensure that the Kāpiti Coast District Council is properly insured, loss modelling and insurance valuations for both infrastructure assets and above ground assets should be completed with sufficient regularity to ensure accuracy of the Kāpiti Coast District Council's PML sub-limits for both types of insurance cover.

28 Insurance risk profiling should also be completed with sufficient regularity to ensure the accuracy of the Kapiti Coast District Council's likely business interruption costs for both types of insurance cover.

29 As noted above, New Zealand Insurers are now looking to set premiums based on technical rates. Quality submissions to underwriters with detailed loss modelling, survey reports and an asset resilience strategy are vital to attract differential (cheaper) pricing from the markets. The WCIG is currently in discussions with Aon to undertake an asset resilience strategy for the Groups infrastructure assets.

30 Aon has recently completed loss modelling determinations for natural catastrophe damage to above-ground assets for the WCIG. These results are still being considered by each participating Council.

Explore changes to Multi Option Line of Credit Facility (MOCL)

31 The Kāpiti Coast District Council currently has a $20 million MOCL. This enables the Council to immediately access to $20 million of new borrowings, if required.

32 For the Kāpiti Coast District Council, losses to infrastructure assets exceeding $130 million in aggregate will need to be self-funded. Additionally, losses to above ground assets exceeding $230 million in aggregate will need to be self-funded.

33 If central government withdraw from their 60/40 funding split, as an alternative to increasing insurance capacity, Council Officers are exploring increasing this MOCL to an amount sufficient enough to further "self-insure" any insurance capacity shortfalls up to 100% of the PML for natural catastrophe damage to infrastructure assets.

CONSIDERATIONS

Policy considerations

34 There are no policy considerations arising from this report.

Legal considerations

35 There are no legal considerations arising from this report.

Financial considerations

36 There are no financial considerations in addition to those already covered in this report. The infrastructure assets resilience strategy can be funded from existing 2017/18 budget underspends. No new money is required.

Tāngata whenua considerations

37 There are no Tāngata whenua considerations in this report.

SIGNIFICANCE AND ENGAGEMENT

Degree of significance

38 This matter has a low level of significance under the Council Policy.

RECOMMENDATIONS

39 That the Audit and Risk Committee notes the limitations currently placed on the Wellington insurance market.

40 That the Audit and Risk Committee notes that the Council has secured sufficient insurance cover for the period 1 October 2017 to 1 October 2018 and is actively seeking to reduce its financial risk exposures on an on-going basis.

Report prepared by	**Approved for submission**	**Approved for submission**
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