Committee:	Date:
Finance Committee	16 February 2016
Subject: Cost of Insurance Premiums	**Public**
Report of: The Chamberlain	**For Information**
Report author: Connie Dale, Chamberlain's Department	

Summary

The report "Revenue and Capital Budgets for Finance Committee Operational Services - 2016/17", submitted to the Finance Committee on 19 January 2016, noted an increase in property insurance costs of £782k. The Finance Committee requested further details to explain the increase in the budget.

This movement is primarily due to an increase in the property insurance premium of £1,410k, partly offset by the dividend income from the City's reinsurance captive (City Re Ltd) of £650k. The increase in the property insurance premium is a result of the combined effect of three independent factors, unusually occurring in the same year, namely:

	£'000
City Surveyor's Revaluation Exercise	168
Market Changes (Pool Re Terrorism)	864
Taxation (Insurance Premium Tax)	378
Total	**1,410**

Given the nature and timing of the changes, the effects could not be mitigated prior to policy renewal in December 2015.

The property insurance programme will be tendered in 2016 which will provide the opportunity to consider changes to the programme structure to maximise market competition and discounts available for deductibles and risk management programmes. A report detailing the options available for the December insurance programme will be submitted to Members in March 2016.

Recommendation

Members are asked to note the report.

Main Report

Background

1. The report "Revenue and Capital Budgets for Finance Committee Operational Services - 2016/17", submitted to the Finance Committee on 19 January 2016, noted the following movement in insurance costs:

Analysis by Division of Service	Original Budget 2015/16 £'000	Latest Budget 2015/16 £'000	Original Budget 2016/17 £'000	Movement (Latest 2015/16 to Original 2016/17) £'000
Chamberlain's – Insurance	10,661	11,883	12,665	782

2. The Finance Committee requested further details to explain the increase in the budget.

Current Position

3. This movement in the insurance budget is primarily due to an increase in property insurance premium, partly offset by the dividend income from the City's reinsurance captive (City Re Ltd), as detailed below:

	£'000
Property Insurance Premium Increase	1,410
City Re Ltd	(650)
Other Costs	22
Total	**782**

4. The Property Insurance Premium Increase is a result of the combined effect of three independent factors unusually occurring at the same time in 2015, namely:

	£'000
City Surveyor's Revaluation Exercise	168
Market Changes (Pool Re Terrorism)	864
Taxation (Insurance Premium Tax)	378
Total	**1,410**

These factors are described in more detail below.

5. The City procures ground up property insurance for the operational and investment property portfolios. The insurance covers material damage to buildings and contents and financial loss from business interruption (for operational properties) and buildings and loss of rent (for investment properties).

6. The contract was awarded to RSA (with Aviva as co-insurer) in 2012 on a Long Term Agreement (three years with an option to extend for up to two years) and was renewed for a further year on 25 December 2015. Damage arising from terrorist acts is procured from Pool Re via RSA.

City Surveyor's Revaluation Exercise

7. The City has a responsibility as Owner/Landlord and, in respect to their commercial investment properties, a legal liability to maintain insurance valuations that reflect the current cost of reinstatement of a building, bridge or

structure in the event of fire. An undervaluation would create a risk of underinsurance and put the City in breach of the landlord's covenant within commercial and residential leases. An overvaluation would generate additional premium for no value.

8. Our valuations are the estimated cost to rebuild the properties, called the Declared Value (DV), against which the insurer's premium rates are applied, resulting in the total premium payable per premises.

9. The City Surveyor undertakes a full revaluation exercise every 10 years (with average uplifts and interim valuations carried out in intervening years). The exercise consists of a site inspection and the valuation accounts for the rebuild cost of the property, professional fees, VAT, and inflationary increases. The market value of the property has no bearing on the insurance valuation. The City Surveyor completed the revaluation exercise in September 2015.

10. A factor of 5% was built into the budget to accommodate the impact of potential increases in the DV but the actual increase averaged 7% (from £11.65bn to £12.51bn as at renewal). The City Surveyor has commented that a major factor in the increase is the strength of demand for construction work which has pushed up contract costs in the industry.

11. The premium rates charged by RSA, which are individual to each property, have remained the same since contract inception in 2012. Changes in the DVs will result in a correlating increase or decrease in the total premium payable. It was not possible to negotiate reductions in premium rates mid-contract term in order to mitigate the effects of the increased DVs. However, the property insurance programme will be tendered in 2016. This will provide the opportunity to consider restructuring the programme in order to maximise market competition and test market rates.

Market Changes (Pool Re Terrorism)

12. The City procures terrorism cover via RSA from Pool Re. Pool Re is a government backed reinsurance vehicle that provides the most comprehensive and financially secure terrorism insurance cover in the market. In 2014, the government changed the charging and dividend structure with Pool Re in order to retain a greater share of the income commensurate with the risk being underwritten. In July 2015, Pool Re consequently announced a restructure to the scheme premium rates and terms, but the details were not finalised and implications assessed until October 2015.

13. Premium rates were increased by 10% for properties in Zone A but these are offset in part by a 10% decrease in the Business Interruption (including Loss of Rent) rate for all zones. Zone A covers all central London postcodes and therefore affects the majority of the City's property programme.

14. Notwithstanding the VAT status of a company, Pool Re has stated that the DV should account for VAT for the purposes of the reinsurance premium calculation, where the insured is unable to recover VAT from HMRC. The City now accounts for VAT on the DVs for all properties where the leaseholder is required to

reinstate/repair. The premium for these properties has therefore increased by 20% on the terrorism element only for the policy year 2015/16.

15. All residential properties are rated at the same rate for terrorism purposes and now benefit from a discounted rate applied to local authorities with residential properties.

16. Pool Re rules require the whole property portfolio to be insured or none. There is no opportunity for rates to be negotiated with Pool Re as they apply to the whole market. However, the tender in 2016 will provide the opportunity to explore alternative terrorism markets and/or to restructure the programme to maximise available discounts for increased deductibles and risk management programmes.

Taxation (Insurance Premium Tax)

17. Insurance Premium Tax (IPT) is a non-recoverable government tax that is charged on the insurance premium. In the Summer Budget 2015, the Chancellor announced an increase to the standard rate of IPT from 6% to 9.5% with effect from 1 November 2015.

18. 2015 was an unusual year in that the 3 factors above occurred at the same time and gave no opportunity to mitigate the effects before renewal of the policy. The combined effect of the above factors has increased the insurance budget for 2016/17 by £1,410k. The dividend received from City Re Ltd, the City's reinsurance captive has offset this by £650k. Accounting for other costs, the increase in budget is £782k.

19. Approximately 75% of the property insurance costs are recoverable from leaseholders and tenants. For information, for the policy year 2015/16 (not financial year) this is split as follows:

	Total Premium (incl. IPT)
Operational (Non-Reimbursable)	£2.7m
Investment (Reimbursable)	£10.1m

Additionally, of the £10.1m, approximately £2m is received by the City as commission.

20. The property insurance programme will be tendered in 2016 and will provide the opportunity to consider changes to the programme structure to maximise market competition and discounts available for deductibles and risk management programmes. A report detailing the options available for the December insurance programme will be submitted to Members in March 2016.

Appendices

None

Connie Dale
Insurance and Risk Manager, Chamberlain's
T: 020 7332 1360
E: connie.dale@cityoflondon.gov.uk