THE REGENTS OF THE UNIVERSITY OF CALIFORNIA

ANALYSIS OF DELAY IN START-UP/COMPLETION INSURANCE – AN EXTENSION UNDER BUILDER'S RISK

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What is Delay in Start-Up/Completion insurance for?

It covers sustained financial losses resulting from property loss/damage to a project that causes a delay in being completed and operational. The cause of the property loss/damage must be covered under the associated All Risk Builder's Risk insurance (i.e., fire, water damage, vandalism, etc.).

What are advantages of coverage?

Delay in Completion coverage provides risk transfer for large projects that have significant exposures of:

- Anticipated large operational revenue streams
- Significant project construction financing (debt or equity) for which debt service terms are preset and locked
- Extra expense/Overhead costs for loss of expected use (personnel acquisition/retainage, use of alternative facilities, etc.)

How does this apply at the University?

Based on recent project information, notably the UCSF Mission Bay Medical Center and the UCSD Jacobs Medical Center, the above risk exposures on large medical center projects should be evaluated for potential risk transfer. The University may have debt service due on a preset payment schedule or other activities dependent on the anticipated revenue stream to be generated. Currently and historically this is an exposure that is self-insured, however based on current soft insurance market conditions, it may be in the University's best interest to consider obtaining insurance to transfer the risk of financial loss.

Who is insured?

The University would be the first named insured and sole loss payee for this extension, unless otherwise agreed in a contract with a third party lender/financing source.

What can be insured?

The University can cover the risk of loss of financial interests caused by a delay in startup/completion following a loss covered under the Builder's Risk insurance. Financial interest includes:

- Loss of gross profit which cannot be earned due to the delayed start-up/completion of the facility. This is the loss actually sustained resulting from the building not being completed and operational. This includes any increased cost of working or specific standing charges; such as interest, fixed costs/overhead, etc. limited to the actual shortfall in earnings resulting from the reduction in turnover during the indemnity period taking into account any additional costs.

- Loss-minimizing expenditures are covered if they prevent, reduce or put a premature end to a delay loss following property damage. The following types of expenditures are among those covered.

    - Express deliveries, air freight
    - Overtime, special shifts, Sunday work and other measures which speed up repair and minimize the delay
    - Machinery rental
    - Purchase of non-identical, but adaptable machinery
    - Acquisition/sale of part-finished products
    - Re-Commissioning of old facilities
    - Switching of work to other companies

Additional coverage can be extended to address the possible sustained losses associated with:

- Project Insurance Premium (additional costs for extensions of coverage)
- Contractors General Conditions
- University's Project Team Overhead
- Legal/Accounting/Professional Fees associated with the continued construction

When is coverage triggered?

Coverage is triggered when a project sustains physical loss/damage that is caused by a peril under Builder's Risk insurance and also results in a delay in completing the project at its original scheduled completion date. Depending upon the declared exposure values and the agreed limit of insurance; costs are recoverable on a sustained loss basis. The recovery will be subject to the applicable deductible under this coverage extension. For large projects, the industry standard is a 30 day period. (Note: this is separate from the Builder's Risk physical damage deductible).

When does the insurance coverage begin and end?

Insurance coverage begins on commencement of work on site or on the effective date agreed. It ceases on the planned or actual date of project delivery/completion. An extension of the project does not automatically mean the period of insurance will also be extended. Any extension must be approved by the insurer.

The indemnity period is the period during which the use of the property is impaired by a delay in start-up/completion due to loss or damage, beginning on the date on which business would have commenced, had loss or damage not occurred, and limited by the agreed maximum indemnity period. The basis for determining the indemnity period is the time needed to rectify the delay loss. This is derived from the duration of repairs to or replacement of the damaged facility including erection and testing.

What are some notable exclusions?

This coverage extension is associated with the All Risk Builder's Risk insurance, therefore, the excluded perils under that policy apply to the triggering of Delay In Start-Up/Completion coverage. Notable examples of excluded perils are:

- Redesigning, altering, adding to or improving the property insured or rectifying defects or faults
- Loss or damage occurring after the project has been taken into use or occupation;
- Loss of or damage to prototype facilities/equipment;
- Inadequate funding to complete the project;
- Claims resulting from fines, damages for breach of contract and other penalties, including liquidated damages.

What are some scenarios that reflect how coverage may or may not apply?

COVERAGE EXAMPLES:

1) A UC medical center construction project is four years into construction and at 95% complete, with one month before scheduled project completion. The remaining work largely consists of finish systems and medical equipment installation. One morning, a finish subcontractor accidentally hits a sprinkler cap on floor 4. As the line is charged, water is released throughout the floor, damaging drywall and medical equipment. The water also cascades down an elevator shaft causing subsequent electrical damage to the elevator systems. The total cost of the physical damage caused by the water, is approximately $6,000,000 in total. However, the impact to the schedule is approximately an additional four months.

   The project has identified and scheduled Delay in Completion coverage based on anticipated "Gross Earnings" exposure, over a twelve month period of indemnity of approximately $60,000,000. As the loss was caused by a covered peril under Builder's Risk and the repair of the damages will result in an additional four months beyond original scheduled project completion, the Delay in Completion coverage extension would be triggered. Subject to the Delay in Completion deductible (typically 30 days), UC could recover approximately $15,000,000 (based on the provided "Gross Earnings" exposure).

   Claim recovery calculation: $60,000,000 annual "Gross Earnings" exposure scheduled on the policy. Assuming pro-rata "Gross Earnings" proforma (agreed in advance by the carrier), four months of delay would result in a $20,000,000 loss. Subject to the policy deductible 30 days (or $5,000,000), the net eligible recovery is $15,000,000.

2) A UC medical center construction project is three years into construction and 65% complete. The project consists of a new hospital tower as well as a central plant. One morning, an electrical contractor is conducting commissioning testing in the central plant. An electrical arch fire erupts during the commissioning and causes significant damage. The total cost of the physical damage caused by the fire, is approximately $5,000,000. However, the impact to the overall project schedule is approximately an additional eleven months, as the completion of the

central plant is on the critical path for the remaining phases of the hospital tower (effectively stops construction for the hospital tower at a specified critical path).

The project has identified and scheduled Delay in Completion coverage based on anticipated “Debt Service” exposure of approximately $29,000,000 over a twelve month period of indemnity. As the loss was caused by a covered peril under Builder’s Risk and the repair of the damages will result in an additional eleven months beyond original scheduled project completion, the Delay in Completion coverage extension would be triggered. Subject to the Delay in Completion deductible (typically 30 days), UC could recover approximately $24,166,667 (based on the provided “Gross Earnings” exposure).

Claim recovery calculation: $29,000,000 annual debt service exposure scheduled on the policy. Assuming monthly pro-rata “Debt Service” payment schedule, eleven months of delay would result in a $26,583,333 loss. Subject to the policy deductible 30 days (or $2,416,666), the net eligible recovery is $24,166,667.

NON COVERAGE EXAMPLES:

1) A UC medical center construction project is three years into construction and at 95% complete of phase 1 of a 3-phased project. The remaining phase 1 work largely consists of finish systems and medical equipment installation. During the commissioning process of installed medical equipment and associated power generation systems, it is identified that the required/specified electrical output for operational use of the medical equipment is not being achieved due to an electrical design flaw. Review of this deficiency takes two months and corrective solutions/rework takes an additional four months. While this situation causes a project delay (to phase 1 and the subsequent project phases), Delay in Completion coverage extension is <u>not</u> triggered because the lower electrical output was <u>not</u> the result of a physical loss/damage caused by a Builder’s Risk peril.

2) A UC medical center construction project is two years into construction and at 70% complete. Based on the medical center’s decision to utilize newly developed/released medical equipment, a project design/scope change is required to accommodate the new equipment. This change, results in an additional six months of construction beyond the original/scheduled project completion date. While the change in scope causes a project delay; Delay in Completion coverage is <u>not</u> triggered because the scope change was <u>not</u> the result of physical loss/damage caused by a Builder’s Risk peril.