THE ASSOCIATION TIMES

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Most Common Excuses for Failing to Maintain Master Earthquake Insurance

By Timothy Cline, CIRMS, Timothy Cline Insurance Agency, Inc.

#1 "The deductible is too high."

Really? Let's see if we understand this argument. A 20% deductible is "too high" but the 100% deductible you have now (with no earthquake insurance) works just fine? Hmmm. A "100% deductible" would not just deplete Reserves but result in enormous special assessments being levied against each owner in the community. These special assessments could easily be four to five times larger than the available $50,000 or $75,000 Earthquake Loss Assessment Coverage options offered by the California Earthquake Authority or CEA.

#2 "It's not the Association's issue. Unit Owners who want to protect their investment can get their own coverage."

You can control how significantly a major earthquake impacts your association, and therefore, the lives of its homeowners.

We welcome the opportunity to partner with any HOA to make it easier for families to recover after a loss.

[Contact us for a quote]

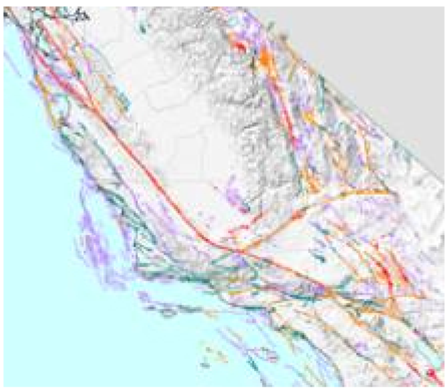
If you live in Unit #401, it's not possible to rebuild your unit unless units #301, #201 and #101 are rebuilt. But rebuilding is far more complex than that. You generally can't insure or repair something you don't own and the Association, not the individual unit owner, owns and has the repair obligation for the Common Area (which typically includes the building exteriors, foundation, utility feeds, wood framing, insulation, and unfinished drywall constituting the floors, walls and ceilings of each unit). Without the shell of the building, how is an owner expected to repair/replace his/her unit? Furthermore, the California Earthquake Authority (CEA), the source for personal earthquake coverage for most unit owners, limits their Real Property coverage to only $25,000. (The $25,000 limit is both the "minimum" and "maximum" amount offered by the CEA.)

3 "We don't maintain earthquake coverage because we're trying to keep our homeowners dues low to make our project more desirable to potential buyers."

Potential buyers are far more concerned with the potential loss of their down payment. Tightening lender's practices in the aftermath of the real estate meltdown means borrowers are required to pony-up larger down payments. No new owner is excited about having to write that large check and having such a large amount of money (now the owner's equity) immediately exposed to loss because the association has no earthquake protection. Buying earthquake coverage means incurring a small known loss (slightly higher homeowners dues) to protect against a large unknown loss (a devastating earthquake).

#4 "We only want California-based insurance companies."

There are distinct advantages of utilizing California "admitted" carriers, but admitted carriers are not always willing to provide coverage because of a given project's size or characteristics (age, soils, parking style, distant to faults). As a licensed insurance broker we're required to conduct a diligent search of the admitted carriers before turning to carriers who are domiciled outside of California. Presently "admitted" carriers represent only about 11% of the commercial earthquake insurance marketplace.



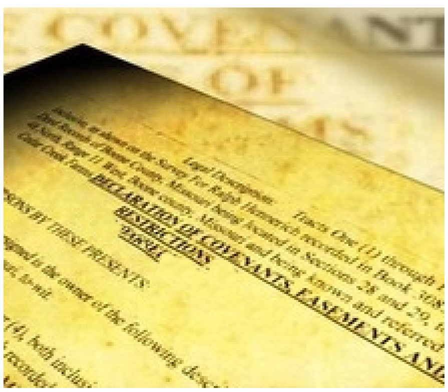
#5 "We're not close to a fault line."

This excuse should probably be corrected to read "We're not close to a known fault line." The reality? Seismologists are discovering new fault lines each year. For example, the Puente Hills Blind Thrust Fault which threatens Downtown LA was only discovered in 1999. Unfortunately, some faults aren't discovered until after an earthquake. The devastating 1994 Northridge earthquake was produced by a fault line previously unknown to seismologists. The deadly earthquake that tore through Christchurch, NZ on February 22, 2011 was the product of a new fault line in the earth's crust that seismologists were previously unaware of. And the Aug. 24, 2014 Napa earthquake was a jolt from out of the blue, involving previously unknown active fault lines as well as faults that were thought to be inactive.

#6 "We don't need earthquake coverage, our building has been retrofitted."

Seismic retrofitting is the modification of existing structures to make them more resistant to seismic activity, ground motion, or soil failure due to earthquakes. Unfortunately, retrofitting is sometimes harder than just hiring a structural engineer and a general contractor. There is a lack of standards for retrofitting and the effectiveness of the methods used may not be known until the next earthquake. Even though there have been a number of earthquakes from which to gain knowledge, there remains a lack of consensus on the appropriate methodology which, for obvious reasons, must be carefully modified and adapted from building to building.

#7 "We don't have to maintain earthquake coverage because it's not required by our CC&Rs."



CC&Rs are typically silent on the peril of earthquake, but that doesn't mean it's not important. Considering most Directors & Officers Liability policies contain outright "property damage" exclusions which eliminate any defense or indemnity for an alleged "act, error or omission" which might arise should the Board be sued for failing to maintain earthquake coverage (and the challenge by an owner or owners arises only after a catastrophic earthquake), it's certainly something a Board should explore on a regular interval.

#8 "After a major earthquake, the insurance companies won't be around to pay our claim."

According to the Insurance Information Institute, the Northridge Earthquake (January 17, 1994) was the costliest earthquake in U.S. history in terms of insured losses (both actual and adjusted for inflation) with a total of $20 Billion (2013 USD) in insured losses. While 20th Century Insurance came close to collapsing under the weight of their earthquake claims there were no carrier insolvencies after the earthquake. Every carrier (including 20th Century) made good on their obligations to their policyholders. Fast forward 20 years, present-day carriers have extraordinarily sophisticated computer programs at their disposal which helps them manage their accumulations along known fault lines. This, along with greater reliance on the risk transfer derived by Reinsurance, significantly reduces the probability that any given carrier will find themselves over exposed after the next earthquake.

#9 "Won't the government/ FEMA help us rebuild?"

To quote a recent email from CAI: "After the 1994 Northridge earthquake, FEMA changed its policy so it no longer assists HOAs. Recently FEMA granted funds to homeowners who were victims of last fall's flooding in Colorado. It paid out to seven homeowners to make repairs from damaged roads that washed up on their properties. Realizing belatedly that the roads, although privately owned, were maintained by an HOA, FEMA is now demanding that those owners reimburse FEMA about $20,000 apiece."

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This letter contains only a general description of coverage and is not a statement of contract. For a more detailed description of the policy conditions and exclusions, please consult the policy itself.

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