Local

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Farr's plan for earthquake insurance debated

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A proposal to start building a $40 billion earthquake-insurance fund for California was debated Wednesday in Santa Cruz before members of a State Senate committee.

The plan, by Assemblyman Sam Farr, D-Carmel, would assess homeowners with mortgages and renters who purchase renter's insurance to begin building a fund that would encourage private insurance companies to offer lower-cost earthquake insurance to California residents.

The plan drew mixed reviews from a variety of witnesses at the hearings held in the Santa Cruz City Council chambers by State Sens. Cecil Green, Frank Hill and Dan McCorquodale.

"We have demonstrated that California is a compassionate state that can handle emergencies but we can't handle the aftermath," Farr told the senators in his opening remarks.

"I hope that there will be some tools (available) that will lead to disaster recovery."

Farr said the insurance industry is terribly frightened about the financial consequences of a major earthquake in California, and that is the main reason companies are setting rates and deductibles so high — high enough that many California residents are deciding that they can't afford the coverage.

The major earthquake now being forecast for Southern California will cause about $51 billion in damage, said Tim Hart of the Association of California Insurance Companies. The entire U.S.-based casualty insurance industry is worth only $153 billion, he added.

Insurance companies don't want to be bankrupted by a single event, the committee members were told, explaining their reluctance to jump into the California earthquake insurance market wholeheartedly.

But the impacts of a major earthquake will extend far beyond the state's borders, Farr said. A major quake, such as the ones being forecast for the San Francisco Bay and the Los Angeles areas, would send fiscal shockwaves throughout the nation.

"If we have a catastrophic quake," Farr told the state senators, "it could bankrupt the nation. It would leave the federal government with a greater deficit than it has now."

The impacts, Farr said, would go far beyond the property damage and lives lost.

The federal government would lose billions in income and other tax revenues. It would spend billions in disaster relief and assistance.

But other major impacts are not so obvious, Farr said. Ten percent of the nation's home mortgages are in California. Owners of quake-destroyed property might just walk away from their obligations — leaving federally insured banks, saving and loans and agencies like the Federal National Mortgage Association (Fannie Mae) and the Government National Mortgage Association (Ginnie Mae) holding the empty bag.

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In such an event, Farr said, holders of federally insured mortgages, the banks and S&L's would all turn to the federal treasury for relief — creating a crisis even greater than the current S&L debacle.

Watsonville Federal Savings Executive Vice President Ted Blackwell took exception to some points in Farr's disaster scenario.

When the Loma Prieta quake devastated Watsonville a year ago, the local savings and loan had 2,100 loans on its books — 92 percent for single-family homes, Blackwell said.

"We thought we would lose $4-6 million of our net worth," Blackwell said. "There was only one instance where we had a loss." And that wouldn't have happened, he said, if the property owner had talked with Watsonville Savings before he demolished the house.

Farr believes that, in the absence of a federal earthquake insurance program — similar to the National Flood Insurance Program, which is now making a profit — it's up to California to entice insurance companies into offering affordable quake insurance in the state.

His plan (AB 3868) calls for the state to become an insurance company to the insurance companies — covering a lot of their losses in the event of a major earthquake.

But homeowners and renters would be paying the premiums — not the insurance companies.

Under the Farr plan, the state over the next 10 years would sell $4 billion in general obligation bonds to get the fund started.

Most of the money, however, would come from California homeowners with mortgages.

They would be assessed 50 cents for each $1,000 of their outstanding mortgage. A person with a $100,000 mortgage, for example, would pay an extra $50 a year to the mortgage holder. That money, in turn, would be turned over to the state.

Renters would also pay 50 cents a year for each $1,000 of coverage.

The money would be held in a special, constitutionally protected trust account until a major earthquake hits California.

At that point, insurance companies could tap the fund to help pay their losses from the quake.

Some of the money would be available every year to homeowners and owners of rental property for no- or low-interest loans to pay for earthquake retrofitting of older homes, Farr said. The Loma Prieta earthquake proved that retrofitting works — most of the older buildings that had been seismically strengthened or just bolted to their foundations in Santa Cruz County survived.

The state treasurer would annually decide how much money would be available in the case of a disaster.

Farr said that the bill, which will be reintroduced next year in the State Assembly, requires insurance companies to sign up for the program by offering substantially reduced earthquake insurance premiums and smaller deductibles.

The plan would supplement a plan authored by State Sen. Frank Hill that goes into effect next year. Basically, Hill's bill requires private insurance companies operating in California to offer $15,000 of low-cost earthquake insurance to all homeowners.

The minimal insurance would have paid for most of the damage, the committee was told, to the homes damaged in the Loma Prieta earthquake.

Some speakers at the hearings questioned the equitability of the plan.

Sen. McCorquodale, for example, wondered about asking people who live in non-earthquake areas of the state, to pay into the state fund.

Farr said that's basically what they are doing now — paying an additional quarter-cent sales tax this year to help repair damage from the Loma Prieta earthquake.

Consumers Union staff attorney Gail Hillebrand said Farr's bill "is not the solution for California."

"The concerns we have are 'who will pay and who will benefit'?" she said.

"Every homeowner (with a mortgage) will pay into the fund but only those who purchase earthquake insurance will get the benefits," she added.

She said there is also no evidence that the insurance companies will really lower their rates.

Besides, she added, "it's not fair to approve general obligation bonds that everyone will pay for but only homeowners will benefit from."

Farr said that's exactly the intent of his bill. "The whole emphasis to this approach is to shift the burden from everyone to those who benefit from it the most — the residential homeowner. I don't know of any other way of setting up this gargantuan fund that has o be set up to implement this program," he told Hillebrand.