ASSOCIATION INSURANCE COSTS IS A CYCLICAL ONE

By: Sara E. Barry, CMCA, PCAM, UNLV Certified Paralegal, Nevada Licensed Insurance Producer

For many years an increase in insurance premiums has been the number one reason that associations give for having to raise assessments. This year it will be a certainty as many carriers now refuse to provide coverage in Nevada. In several recent arbitration cases in Nevada, insurance increases (because of multiple claims) and the Board's inability to pay those premiums became a serious issue. The Board asked for a vote of the owners for a special assessment to fund the insurance, but the owners voted it down, which resulted in the board's use of reserve funds to pay the premiums. This was, however, after consulting with their attorney and CPA to try to try alternatives. Having none, the decision was made to borrow the reserve funds as the possible consequence of ending up in front of the CIC Commission for reprimand was far less severe than not having insurance. An owner sued them for improper use of the reserves, but an arbitrator ruled in favor of the association.

Unfortunately, very few board members realize that the nature of association insurance is a cyclical one. For any board, however, to plan accurately for insurance expenses, it is essential to be aware that there is a phenomenon known as "the insurance cycle" and that it exists.

How does it work? Insurance company revenues are a combination of premiums paid and investment income (interest earned on capital and on monies being held in reserve against future payment of losses.) These two income sources must generate more money than the combination of an insurance company's expenses and its losses if the company is to stay in business. Insurance pricing therefore reflects the goals of the individual insurance companies. In order to attract and retain capital investments to this industry, the rate of return on investment must be competitive with that of other investment opportunities.

Insurance is basically a good example of the economic theory of supply and demand. The demand for insurance continues to grow fairly steadily with inflation and development, as properties increase in value and the number of properties increases, and as liability costs continue to rise. In contrast, the availability of insurance, both primary and reinsurance, rises when interest rates are high and falls when interest rates are low. As the supply falls, insurance becomes less available and therefore prices rise.

In addition, prices often are set before some underlying costs (such as necessary loss reserves) are known. Because it can take three or more years to settle some claims, efforts to predict accurately reserves to pay for these losses are often fraught with errors. To complicate the issue, some analysts argue that each cycle has been influenced by costs which were not anticipated in companies.

Generally, association that are hit with dramatic increases in their premiums are those that, in a soft market, held budgets steady or even reduced assessments by using the premiums saved through “price-shopping.” But, changing companies solely for price savings can have a long-term negative effect on the protection of the association’s assets because it may reduce the extent of coverage, quality of service, and overall value of the insurance purchase. It may also remove the association from the “protection” of an agency or company which can retain capacity to continue offering insurance during a hard market.

With several carriers refusing to bind coverage in Nevada because of the Higher Ground law suits, now is not the time to play games with your insurance. The carriers are having to spend a considerable amount of their reserves in defending these lawsuits. Relationships are critical with your agent to help convince the carriers to not cancel your insurance at renewal time. Your agent and his or her relationship with the carriers goes a long way in determining who to keep and who to get rid of in determining profitability for the carrier.

The basic procedures to be used for the selection of an insurances program remain the same, whether the market is a buyer’s or a seller’s market. The key to success, however, is identification of the association’s goal and working with appropriate professionals to achieve that goal. If the goal is meeting the expectations of the association for proper “asset protection,” the board will not buy insurances on the basis of price or friendship, but will seek real value in the breadth of coverage and will include service and professional guidance in its decision making.

The first **s**tep in selecting an insurance program is to define the association’s minimum insurance needs, which can be determined by working with an HOA industry experienced insurance professional, working with the association’s attorney from a review of state statutes and local ordinances, by a careful review of the association’s documents and by checking with secondary mortgage market requirements.

The second step is to explore the boards and the owners’ expectations as to the extent and character of coverage, and the insurance agency’s capacity for support services including how claims will be handled at the time of a loss. Also take a careful look at what liabilities have been assumed by contract which might be transferable and what superfluous insurance coverages are being carried. Having an HOA specialized attorney review all contracts will help to minimize a lot of the contractual liability you are asked to assume by your vendors. (See the checklist of questions to ask in interviewing for your legal counsel.) If associations had all had their attorneys review and help negotiate the collection contracts, many associations would not be in the position they are in by having to defend some collection agencies who helped in creating this mess because of greed.

Back to Insurance: To get the best coverage, it is important to understand the differences between a buyer’s market and a seller’s market. In a hard market, the insurance carrier, not the buyer is selecting his contracts. At this time the association needs more than ever, to make itself attractive to the insurance carrier, through its agent.

In a soft market, on the other hand, the buyer is in control, the prices are low, and the competition for business will lead to more availability of broader coverages. As the cycle changes and the market hardens, the seller regains control and insurance availability goes down as premiums go up.

So, what makes an association more attractive to the carriers? To be desirable as a potential risk to an insurance underwriter, an association must show the agent and the company the potential for making a profit. Since the first-year costs are far higher than renewal costs, and since working with a known entity is more secure than with a new risk, the association that has stayed with the same agent and/or company for an extended period is more likely to be profitable to the carrier. Thus, to the insurance company, a record of stability is important. All too often associations elect to go out for bids “just because” or it becomes a power play where anything the old board had must have been bad and we are changing everyone.

Planning ahead can ease the process of acquiring adequate insurance coverage for the board and ultimately the association. Recognizing the characteristics of the insurance cycle and, to the extent possible, removing the association from the full impact of it, will help the association budget in both the short and the long term. A professional can assist the board both in planning for premium changes which lie ahead and advising on what long-term planning efforts will cushion special programs and alternative mechanisms should be examined for the options they may offer to assure long term stability.

………… end …………