

Quake Qualms

California earthquake sends ripples through facility, storage industry.



Photos of Napa Self Storage courtesy of RMB Management Co., Inc.

By Laura Williams-Tracy

An earthquake in California has put a self storage operator on shaky ground with long-time customers as it faces a challenging situation to remove tenant belongings from a damaged building while absorbing uninsured losses.

The earthquake that struck Napa, California, in the early morning hours of August 24, was the area's strongest quake in 25 years, measuring 6.0 on the Richter scale.

Self Storage Association member Napa Self Storage sustained damage to more than 80 percent of its storage units, with the worst damage happening at its newest and largest building, a two-story facility built in 1994 with 237 units. With right angles seemingly hard to find in the quake-damaged metal-clad building with bowed walls and cockeyed staircases, local authorities "red-tagged" the structure, designating it beyond repair and too dangerous to enter. The building will have to be demolished.

The quake also damaged two other one-story buildings on the site, known as the 300 and 500 buildings, totaling just over 200 units. Those can be repaired at a cost of nearly \$500K.

Napa Self Storage did not have earthquake insurance, and the business will have to absorb the losses.

Beyond the substantial business losses to Napa Self Storage, the quake set in motion a contentious debate between management and tenants in the largest building. Because government engineers deemed the building too damaged for entry, tenants have not been able to enter and remove their belongings or even determine their condition. The cost to brace the building so that it can be made safe for entry is estimated at \$200,000, an expense that tenants and Napa management have been at odds over who should pay.

Whose Responsibility?

Napa, which faces the expense of replacing the building without the help of insurance, is not in a position to fund the bracing project, said Miranda Evans, spokeswoman for RMB Management Co. Inc., the co-owner and management company for Napa Self Storage. "This work is solely to go in and get the tenants' belongings out. To demolish the building we don't need to brace it."

In December, Napa Self Storage received city approval for a plan to shore up the ruined building so tenant belongings could be brought out. Napa Self Storage then presented to tenants a plan by which tenants would pay for the bracing. Assuming participation by at least 70 percent of the building's tenants, each would pay between \$700 and \$2,000—depending on the size of their unit—or about a year's worth of rent.

"That plan wasn't very well received by the tenants," Evans said, and by mid-January Napa had not received enough tenant participation to fund the project.

Meanwhile, the bank that holds the note on the damaged building wants Napa to move ahead with demolition. Evans said Napa still has a mortgage on the destroyed building and will have to absorb that loss. Management is considering whether it makes sense to build a new storage facility, an RV lot or some other storage use.

The situation Napa Self Storage finds itself in highlights risks that businesses can't always insure against.

Can Insurance Help?

"Legally this is an oddball situation to have occurred," said Carlos Kaslow, SSA general counsel. "You've got a situation where a landlord has an uncovered loss and tenants want access to the property. Who is going to fund it?"

Kaslow said it's not an easy case for the tenants. "I don't know the landlord owes a duty to shore up the building so they can get inside. Where does that duty arise from?"

Even if Napa Self Storage had earthquake insurance—which it didn't in part because it's almost impossible to buy in California—the policy would have been unlikely to cover the cost of stabilizing the building before its ultimate demolition. An earthquake policy would have paid to replace the building, but only after the owner put up a deductible likely to have amounted to 20 percent or more of the replacement cost of the building, at least several hundred thousand dollars.

"Customers in California don't even ask for earthquake insurance," said Chris Nelson, underwriting supervisor for MiniCo Insurance Agency, LLC in Phoenix, which offers earthquake insurance to the storage industry in many parts of the country. "California is the one state we don't offer it, for obvious reasons. No insurance company is going to insure an event that is going to destroy a whole book of business."

What about tenant insurance and the help it might provide the tenants who need financing to access the building?

Kaslow said tenants covering their storage goods with their homeowner's policy are unlikely to have earthquake damage coverage for those belongings. Even for homeowners who have earthquake coverage, the policy covers the storage unit's contents, not the building containing them.

Tenant insurance companies Bader Company and Deans & Homer consider earthquakes to be a "covered peril" under their tenant policies. But again, those policies protect the contents.

"The predicament these customers have is that even if they have tenant insurance, they can't verify if there is earthquake damage," said Ted Dobbs, vice president of sales at Deans & Homer. "Not having access is not a loss."

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But tenants are angry about their lack of access and have threatened to sue Napa Self Storage for access. Kaslow said that argument is unlikely to prevail. Similar arguments were made by tenants after storage facilities were damaged or destroyed in New Orleans after 2005's Hurricane Katrina.

"The argument of being locked out didn't go very far," Kaslow said. "The lawsuit was dismissed, and the court pointed out it wasn't the owner locking them out but government authorities."

But if Napa Self Storage has to defend itself from tenant lawsuits arising out of the earthquake damage, might customer goods legal liability insurance help?

Kaslow said even this insurance won't likely help Napa management pay for shoring up the building. Customer goods legal liability is purchased by storage owners to help pay for their legal defense if they are sued by tenants. Kaslow said if the owners must tear down the building—and in the process destroy tenants' belongings—the insurance company may view the demolition as an intentional act, which sparks a tenant lawsuit. Intentional acts are excluded from coverage.

"The owner is going to argue it's not intentional because they are under orders from the government to tear it down,"

Kaslow said. "The typical insurer is going to tell them to let us know when you get sued, and we'll deal with it then."

In the meantime, the insurance has provided no funds toward resolving the issue and helping tenants regain their belongings.

Kaslow said the best solution is likely one in which both sides share the cost of shoring up the building for the tenants to remove their belongings. The dilemma is how to get enough tenants to come together to share the cost.

"There's a good chance the situation will end with a loss on both sides, with tenants losing their belongings and the owner losing the building," Kaslow said.

Napa Self Storage has been in business in California's wine country since 1984 and is owned by the founder as well as three siblings, who together make up RMB Management. Evans said that while the losses are great, the business will survive.

"We have to get the 300 and 500 buildings up and running to be profitable," Evans said. "And of course, we'll have to tighten the belt and cut down on costs. It's a tough situation. We're trying to make the best of it." ❖

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