



In the next  
Carlson Report:  
Old Insurance as  
a Valuable Asset

## Environmental Insurance Facilitates Real Estate Deals

Like the nation's first cell phones—clunky, costly, and limited in scope—early versions of environmental insurance didn't really suit the real estate market. Nowadays, almost everyone carries a cell phone of some design. Similarly, environmental insurance has become a much more useful way to manage risks.

Environmental risks associated with property transactions can include:

- Contamination that is not discovered during due diligence
- Cleanups that exceed cost estimates
- Contamination that migrates to adjacent properties
- New contamination discovered after remediation

## Environmental Insurance Evolves

Beginning in the 1970s, businesses found themselves paying for expensive environmental cleanups brought about by stricter federal and state laws. Many turned to their insurance companies for help and pursued claims under their Comprehensive General Liability (CGL) policies. However, as claims became more and more costly, insurers effectively said, "Enough is enough."

In 1986, the industry enacted the "absolute pollution exclusion." This meant that environmental risks occurring after 1986 would no longer be covered under CGL policies. In place of CGL coverage, the insurers introduced specialized environmental policies. But these were limited in scope and did little to address the environmental risks companies feared.

Today, it's a different story. Voluntary cleanup programs, "clean" letters, and improved risk assessment practices have reduced the uncertainty that made insurers nervous. Coupled with an economic boom, this has created a market well suited for environmental insurance that continues to expand.

Kenn Anderson, Director of Environmental Business at AON, estimates that over \$1.5 billion in environmental insurance premiums were written in 2000, with about 40% being devoted to real estate deals and mergers and acquisitions. Additionally, he reports that premium volume has been increasing about 20% per year for the past five years and pricing is the lowest in 15 years.

## Insurance Product Overview

### 1. Pollution Liability

The most common coverage sold today is Pollution Legal Liability (PLL), which insures property owners for contamination discovered on their property even if it occurred decades before. Pollution Liability also covers the cost of cleanup above the deductible and protects against third party claims.

According to Max West, Assistant Vice President with Marsh Environmental Practice, "Pollution Legal Liability protection can be used as a tool for the completion of a property transaction. In addition these programs can be strategic tools in finding a buyer because they are transferable from the owner to the buyer."

**Coverage:** A policy with \$5 million in coverage, a 5-year term and \$50,000 deductible, costs between \$35,000 and \$45,000. On the high end, single insurers can provide up to \$100 million in coverage, and multiple insurers can provide virtually unlimited coverage.

**Benefits:** Highly customizable; can "grease" the deal by substituting for or supplement indemnification or other methods of risk allocation; helps quantify the risk for resale.

### 2. Cleanup Cost Cap

This highly customizable insurance covers cleanup cost overruns for several scenarios:

- Known contamination greater than estimated or newly discovered
- Off-site cleanup costs if pollutants originated from on site
- Regulatory change resulting in stricter cleanup standards.

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To qualify for CCC, there must be a well-defined project with a remediation plan and cost estimates. This highly customized policy applies to brownfield sites, RCRA or Superfund projects, and mergers and acquisitions and is used by site owners/developers, potentially responsible parties, and contractors/consultants.

**Coverage:** The premium is based on a percentage of the expected cleanup costs, typically about 10%, plus a buffer. The total will vary depending on the property size and history. CCC coverage is not available for cleanups that cost less than \$500,000. Policy periods usually last from 1 to 10 years.

**Benefits:** Highly customizable; controls cleanup costs; cost estimates may be used in making property valuations; policy enhances property value.

### 3. Secured Creditor

Secured Creditor coverage protects lenders from financial loss due to loan defaults associated with environmental contamination. Coverage requires two triggers: (1) the loan must default; (2) there must be environmental contamination. The policy pays back the loan amount.

Comments Jane Bolin, Assistant Vice President, First Union Insurance Group, "Secured creditor environmental insurance works very well at First Union. It transfers environmental risk out of the bank's portfolio, and it has benefits for our customers as well. Environmental insurance costs less than a Phase I in most cases, and the turnaround time is faster—2 to 3 days instead of 2 to 3 weeks."

Keep in mind, however, that the secured creditor policy protects only the lender, not the borrower, and it skirts the issue of the value of collateral. A Phase I assessment and perhaps other work would still be needed to address these issues.

**Coverage:** Premiums for coverage under \$1 million can be as little as \$200 on a portfolio basis. For projects over \$1 million, the amount will be closer to \$1000, depending on the number and type of loans.

**Benefits:** Streamline loan approval process; protects loan equity; offers cost savings if Phase I and environmental review are not conducted; facilitates the selling of loan pools that may contain contaminated properties.

## Getting Insured

If you need environmental insurance, then you will want to work with an experienced environmental insurance broker. The business is complicated. No two environmental insurance policies are the same, and policy language and coverage provisions are highly negotiable.

The broker's job is to gather all pertinent information and present it to multiple underwriters. Notes Susan Neuman, President of the Environmental Insurance Agency, Inc., "Underwriters from different insurance companies may offer highly divergent quotes in terms of coverage and price for the same risk. This is because companies may have different appetites for risk and follow different underwriting guidelines. All in all, the process can be very subjective."

Because of this flexibility, terms and conditions must be understood precisely, and coverage and exclusions must be worded exactly. An environmental insurance broker will ensure that the terms of coverage are sufficient and fairly priced. The broker will also monitor coverage and assist with any claims.

## Something for Everybody

With competition driving low costs and users needing customized products, look for environmental insurance to play a leading role in real estate deals and business transactions of the future. The days of the clunky cell phone and restrictive environmental insurance policies are history.

### For Further Information

For in depth analysis, see articles by:

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Major Insurance Companies' Websites:

- [www.aig.com](http://www.aig.com)
- [www.zurichpolicy.com](http://www.zurichpolicy.com)
- [www.kemperenvironmental.com](http://www.kemperenvironmental.com)
- [www.ecsriskcontrol.com](http://www.ecsriskcontrol.com)

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