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Managing Environmental Risks for Borrowers & Lenders...

Tools to Help Mitigate and Manage Environmental Risks & Liabilities

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The Market: *The Major Players*

- AIG Environmental
- Zurich North America (*lender policy*)
- Chubb Environmental Solutions
- XL Environmental
- ACE Environmental Risk

Insurance Policies to Protect:

- Borrowers & Lenders
- Buyers & Sellers
- Tenants, Owners & Operators

...against Environmental Risks & Liabilities

Environmental Insurance

- Managing Environmental Risks in Corporate Real Estate Transactions
- *Environmental Insurance* – “another tool / option to consider to manage and mitigate environmental risks and liabilities” ...

Types of Policies & Coverage

- Secured Creditor Policy (Lender Policy)
- Pollution Legal Liability (PLL- Borrower)
- Cleanup Cost Cap (CCC)

Claims-made & reported policies – surplus lines tax applies

Risk vs. Liability...

- Underground Storage Tank (UST)
- Lender (mortgage / collateral)
- Phase I ESA

Question: ?

- Is a UST a Risk or a Liability to a LENDER?

Secured Creditor Policy

- Policy protects the lender only
- Two types of Lender policy forms:
"OLB" & "Lesser of"
- Coverages A, B (*OREO*) & C (*third-party*)
- Zero deductible (pays first dollar)
- *No foreclosure required by lender under coverages A & C*

What CRE Mortgage Lenders Fear Most

- Loss of Collateral Value (LTV%)
- Inability for borrower to repay the loan (debt service) due to environmental conditions / issues
- Liability for environmental conditions AFTER foreclosure – OREO
- Very difficult for any bank to sell CRE with contamination (soil or groundwater)

Lender Policy

Coverage's A, B & C

- Coverage "A" pays the lender the Outstanding Loan Balance (OLB) in the event of a default AND a pollution condition.
- Prior to foreclosure - NO foreclosure required by bank under Coverage "A"

Lender Coverage

- Coverage “B” pays for first-party cleanup of on-site pollution conditions at the insured properties owned by the insured.
- After foreclosure – OREO
- Policy pays for cleanup costs - up to the limits of the policy

Lender Coverage

- Coverage “C” provides coverage for on-site third-party bodily (BI) & property damage (PD) claims, caused by a pollution event from a covered location – policy includes defense costs (within the policy limits)...
- *NO default required to be paid under Coverage “C”*

Summary of Lender Policy Benefits...

- TIME: 3 day turnaround on most loans and 24 - 48 hour response using the automated system
- COST: one time premium is paid by borrower at loan closing – policy can provide coverage for loans for lender - up to 15 years
- TRANSFER RISK: Phase I will not pay to cleanup the property, pay third-party claims or pay off the loan balance for the lender

Types of Properties

- Offices / Commercial
- Hotels
- Retail Stores
- Warehouses
- Vacant Land
- Apartments – Multi-family
- Shopping Centers
- Medical Facilities

Properties NOT insurable

- Industrial sites
- Manufacturing sites
- Properties with known environmental contamination above actionable regulatory levels
- 1-4 family dwellings (residential)
- Gas station sites over 10 years old
- Dry Cleaners sites over 5 years old

Coverage Highlights...

- Zero deductible
- Primary Insurance
- Policy responds to changes in cleanup standards (local, state & federal)
- Policy provides coverage for **pre-existing unknown** conditions prior to loan AND **new conditions** coverage after the loan is closed
- Once approved by Zurich – lender has 120 days to close loan

Pollution Legal Liability (PLL)

- Also known as an owners / borrowers policy
- Covers environmental risks that come with owning or operating a facility or site
- PLL policy used to protect buyers and / or sellers from Environmental Liabilities in business transactions (*M&A and divestitures*)

Pollution Legal Liability (PLL)

- STANDARD COVERAGES
- On-site cleanup of historical conditions
- On-site cleanup of new conditions
- Off-site cleanup of historical conditions
- Off-site cleanup of new conditions
- Third-party claims for BI & PD
- Defense Costs (legal expenses)

PLL Optional Coverages

- Business Interruption
- Underground Storage Tanks (UST)
- Above Ground Storage Tanks
- Bodily Injury caused by lead-based paint
- Bodily Injury caused by asbestos
- Environmental Liability assumed under contract
- Natural Resource Damages (NRD)
- Non-Owned Disposal Sites (NODs)
- Mold Coverage

Cleanup Cost Cap (CCC)

- Policy is designed to address the risk and uncertainty associated with beginning or continuing an environmental remediation project
- Covers cost overruns when environmental remediation costs exceed the projects projected costs...

Environmental Insurance

- **Cleanup Cost Cap:** protects the insured against cost overruns associated with the known conditions (cleanup costs) at a site
- **Pollution Legal Liability: (PLL)** protects the insured against liability arising from unknown pre-existing and new pollution conditions

Important Issues to Consider...

When buying an Environmental Insurance Policy

- Who is the insured ?
- Length of policy period
- Limits (per loss/aggregate)
- Form of Coverage
- Policy Exclusions...

Other Issues to Consider...

- Price of Policy
- Information needed to underwrite
- Turnaround Time to Underwrite
- What is actually covered & not covered

Other Issues to Consider...

- Agreements and /or contracts
- SIR / Deductible, if any
- Triggers of policy to pay claim
- Endorsements – add / remove

Due Diligence & Options

1. Extensive site characterization
(Phase I & II)
2. Price adjustment of purchase price
3. Indemnification agreement
4. Escrow account
5. Walk away from the deal
6. *Environmental Insurance*

More Information...

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