ENVIRONMENTAL

BROWNFIELDS

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VARYING DEFINITIONS, COMMON CONCERNS

Most property owners, buyers, sellers and developers are familiar with the term "brownfields," but this term can have different meanings and bring with it a whole host of concerns depending upon one's perspective (new found opportunity or potential liability). Fortunately, insurance can play an important role in insulating the opportunity or limiting the concerns.

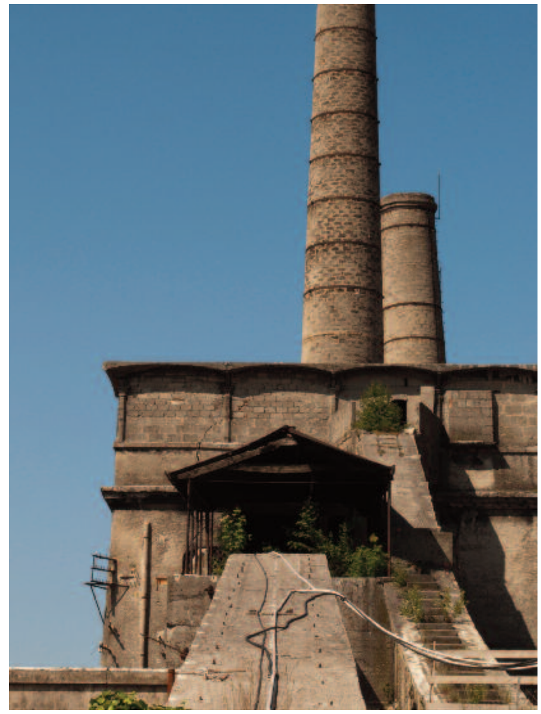
The U.S. EPA defines brownfields as "real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of hazardous substances, pollutant, or contaminant." Others define it more simply as *real estate with environmental personality*.

Generally speaking, real property is viewed as a valuable asset; however, most brownfields remain unused or underused because of real or perceived contamination and its associated liabilities. The two major concerns are potential legal liability/toxic tort scenarios and potential remediation expenses/cleanup costs.

KEY ENVIRONMENTAL EXPOSURES

Brownfield sites can pose a range of exposures for owners, buyers, seller, developers and even lenders and investors, including:

- Third-party claims – Pollution-related property and/or bodily injury damages
- New issues – Discovery of new or additional contamination/pollution conditions
- Government "reopeners" – Regulatory determination of more stringent cleanup requirements (virtually no environmental cleanup is ever unequivocally "closed" as states/regulatory authorities rarely ever issue an unconditional release of liability); several "reopener" contract qualifiers allow the government to reassess site previously deemed "closed"/clean
- Cost overruns – Exceedance on cleanup projects



INTERESTING BROWNFIELD FIGURES/FACTS

- **No one knows exactly how many brownfields there are, but estimates range from 400,000 to more than 1,000,000 in the U.S. alone.**
- **As much as $2 trillion of real estate may be undervalued due to the presence of contamination.**
- **Environmental hazards are estimated to be present at 20-50% of all industrial real estate properties.**
- **Brownfield funding sources available at the federal, state and local level — Grants, matches, loans, tax incentives.**

Source: 2010 National Brownfields Association

- Contractor-caused pollution – Creation of new pollution from activities of contractors
- Financial defaults – Bank/financial institution exposed if borrower defaults due to environmental liabilities.
- Consequential losses – Such as business interruption or loss of tenant revenue resulting from pollution incidents

WEAKNESS OF TRADITIONAL APPROACHES

The magnitude and uncertainty of the consequences of environmental risks have led buyers, sellers and developers to be very cautious. This caution is illustrated in a variety of approaches used to mitigate the environmental risk posed by various property transactions (each possessing fundamental inefficiencies and disadvantages as outlined below).

APPROACH	DISADVANTAGES
Price discounting	■ Can lead to severe under/over-estimation of underlying risk ■ Risk estimates can vary widely; third-party verification often unavailable
Buyer/seller indemnification	■ Difficult to negotiate ■ Dependent on the future financial viability of indemnitor
Escrow and hold-back provisions	■ Difficult to structure/estimate and can require complex ongoing administration ■ Can reduce transaction value to one or both parties

REAL SOLUTIONS & RISK MANAGEMENT STRATEGIES

An increasingly attractive alternative is transferring these risks into the environmental insurance market. For a single, fixed premium, environmental insurance can be used to protect against the risk of unexpected future losses – providing more certainty and comfort to all parties.

Effective risk management of environmental exposures during brownfield redevelopment may also entail an integration of contracting strategies coupled with insurance solutions. The right contracting strategy will allow a site owner to achieve the most efficient balance between retaining risks and transferring them to third-party contractors.

Site owners have many options for negotiating terms with contractors for cleanup of contaminated sites. These options allow for varying levels of risk to be transferred from the site owner to the remediation contractor. Additionally, integration of remediation and redevelopment construction contracting has been shown to generate cost savings and efficiencies. A growing market of firms, primarily from the environmental engineering services sector, is pursuing opportunities to help contaminated property owners resolve liability issues through such transfers.

Key benefits of using innovative contracting and insurance solutions to transfer environmental liability include:

- Cost certainty and stakeholder reassurance
- Increased creation of real estate value
- Transaction facilitation
- Improved disclosure and accounting treatment of liabilities
- Reduced distraction on non-core activities

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KEY ENVIRONMENTAL INSURANCE OPTIONS

The fundamental environmental exposures identified in the preceding section can be addressed with appropriately structured insurance programs. These insurance solutions can be introduced to virtually any transaction structure. A few of the key insurance products are detailed below and summarized in the following table:

POLLUTION LIABILITY INSURANCE

The unknown and future environmental exposures associated with brownfields can be effectively managed with a Pollution Legal Liability policy. These policies can be structured to address unknown/unanticipated pre-existing (historical) and/or new (operational) pollution conditions. "Known" conditions that have been properly delineated and previously remediated can often be incorporated.

REMEDIATION COST CAP INSURANCE While there have been significant restrictions in market appetite and limited scenarios in which a carrier will consider writing, a cost cap or "stop loss" policy is designed to pay for unanticipated, additional remediation project costs once they have exceeded original estimates. Such a cost overrun might result from a variety of sources, including the discovery of additional contamination, underestimation of base costs or changes in regulatory requirements.

BLENDED INSURANCE PROGRAMS It is possible to transfer both known cost items (i.e., identified remediation obligations) and the associated unknown risks (for example, potential overrun) using a combination of pre-funding and conventional cost cap insurance. These so-called blended programs are typically combined with a Pollution Liability policy to cover third-party liability claims.

In essence, insurers will charge a premium to fund the predicted remediation expenditure with an additional charge to transfer the cost overrun and timing risks. Since they are future costs, the estimated remediation costs are discounted to an appropriate net present value.

TYPE OF CONTAMINATION	TYPE OF INSURANCE/PURPOSE
Unknown	■ Pollution Liability Insurance
Known	■ Remediation Cost Cap Insurance ■ Blended Programs

CASE STUDIES

REAL ESTATE COMPANY

Willis represents a major real estate client that purchased a large parcel of property in midtown Manhattan. The site was previously impacted by former manufactured gas property operations and petroleum-based hydrocarbon contamination from an adjacent gasoline service station. Some limited indemnification was provided by the local utility company and the NYDEC involvement and oversight was significant. The site was to be cleaned up and redeveloped for residential and mixed-use purposes (two 57-story towers consisting of rental apartments, retail spaces and parking). The insurance program structured by Willis enabled the property owner to transfer its environmental liability and begin the development. The project has since been completed and is currently put to use as originally intended.

MAJOR INDUSTRIAL FIRM

Willis represented a major industrial firm in their exit from liability of a formerly owned site contaminated from more than a 100 years of industrial activity. The high value riverfront parcel was to be cleaned and redeveloped into multiple residential and commercial projects. The insurance program structured by Willis enabled the former site owner to transfer its liability, the current site owner to transfer the property to redevelopers, and the redevelopers to qualify for project financing and expedited regulatory determinations as part of the site's inclusion in a formal state-sponsored brownfields program.

REDEVELOPMENT JOINT VENTURE

Willis represented a redevelopment joint venture between a home builder and a property management firm in their efforts to convert a former food products factory into a high-end condominium complex. The insurance solution designed by Willis allowed the required environmental cleanup elements of the overall project to be performed with cost certainty – a requirement by lenders financing the project.

JUMBO RESIDENTIAL/COMMERCIAL DEVELOPMENT

Willis placed the environmental insurance covering a $2B residential and commercial development project in Manhattan on a site with prior heavy industrial usage. The situation was complicated by incomplete definition of site conditions, lack of clear regulatory positions, and impacts from ongoing operations. The solution offered by Willis was a structure in which cleanup responsibility and liability were transferred in perpetuity for a fixed price and backed by a long-term insurance program covering costs expected to exceed $100M.

WILLIS BROWNFIELD ACTIVITY/INVOLVEMENT

Beyond complex environmental insurance placement work, Willis also participates in and serves on various brownfield-related panels and working groups, where we provide valuable insights into how environmental insurance can play a vital role in transferring risk and helping move projects forward. For instance, Willis is active in the Washington Department of Ecology's (WDOE) efforts to rework its brownfields program. The WDOE, in consultation with the University of Washington, public entities and other stakeholders, has gathered a team of professionals with expertise in environmental policy, law, engineering, consulting and insurance to develop new methods and processes for improving efficiency in brownfield redevelopment. Providing this type of consultation has been welcomed by regional agencies and policy makers throughout the state, and environmental insurance guidance and options are an important component of the program. In addition, Willis is working with both the University of Washington's oversight panel and with the team of consultants hired by WDOE to develop the framework.

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