

Welcome to the seventh issue of our Bulletin issued by the Property Investors Sector of Risk Solutions. We hope you find articles here of interest to you. Should you require any further information on any of the topics covered, or require additional copies, please contact one of the Sector members listed on the back page who will be delighted to assist.

## Management of Asbestos

**As reported in Issue 6 of Property Bulletin the Control of Asbestos at Work Regulations 2002 which were published in October last year come into force on 21 May 2004. The Regulations which address the biggest occupational health killer in the UK, will result in fundamental changes to the law governing asbestos in buildings.** The new regulations will impose a new "duty to manage asbestos" as well as creating the role of "dutyholder". This will affect anyone who owns, occupies or manages property. While May 2004 is still some distance away action needs to be taken now to ensure that the necessary steps are taken to ensure compliance. Broadly the duty to manage under the Regulations will require those who have responsibility for maintenance activities in non domestic properties to:

- Find out if there is asbestos in the premises, the amount and the condition it is in
- Presume materials contain asbestos unless there is evidence they do not
- Make and keep an up to date record of the location and condition of the asbestos containing material
- Assess the risks from the materials
- Prepare a plan setting out how the risks from the materials are to be managed

- Take the necessary steps to put the plan into action
- Provide information on the location and condition of the materials to anyone who is liable to disturb them.

These Regulations will be enforced by the Health and Safety Executive and will have legal implications both for existing properties and for transactions where the presence of asbestos containing materials will need to be raised during the due diligence process and dealt with accordingly.

From a practical point of view it is essential that work is commenced early to ensure compliance and that the dutyholder familiarises himself with the HSE guidance notes. This subject needs to be addressed by landlords and managing agents. They need to establish whether professional assistance is required and, if so must ensure that the credentials of any professionals are checked. Willis are able to offer guidance and assistance on these new Regulations if required and for further information please contact Mike Mooney.

### Contents

- Management of Asbestos Property Seminar
- Outsource your contamination liabilities
- RVI for commercial property
- Topics in brief:
  - An expensive mushroom
  - D&O Newsletter
  - Damage caused by uninsured risk

### Property Seminar

On 28 November last year the Property Investors Sector held a successful Seminar in the Tower Room at Ten Trinity Square which was attended by over 50 delegates. The keynote speakers were:

**Paul Clark**, Senior Property Partner at DJ Freeman who spoke about the legal implications of managing property risks in the current difficult insurance market place particularly those affecting landlords and tenants and their responsibilities under leases.

**Philip Reynolds**, Manager of Royal and Sun Alliance's London and Specialist Business who provided an overview of the insurance market one year after 11 September 2001 and the problems that continue to dominate it.



Environmental:

# Outsource your contamination liabilities

**The concept of being able to outsource or 'buy out' of environmental liabilities is tried and tested in the United States. Specialist remediation companies, such as TRC Inc., will, for a fixed cost, release owners from their contamination liabilities in perpetuity. Such strategies have become an increasingly attractive proposition for developers, financiers and fund managers looking to focus on core activities and upside opportunities.**

The environmental liability buy out model is now available in the UK. WSP's Active Transfer® initiative provides a compelling new tool for companies seeking an exit from environmental risks whilst retaining ownership and control of the relevant property assets.

Environmental risks such as land contamination, and the associated stigma attached to such issues, have proved very hard to quantify accurately and therefore manage. The implementation of the new contaminated land regime in the UK and the spectre of further EU driven legislation in this area serves to add to the uncertainty. In recent years, the property market has given increased consideration to the presence of environmental liabilities such as contaminated land and hazardous building materials. This has led to the use of Environmental Due Diligence (EDD) in most property transactions to identify and assess the significance of these environmental liabilities. Once identified, buyers will use a variety of techniques for managing their exposure to these risks. Options include vendor indemnities, purchase price adjustments and more recently the use of new environmental insurance solutions.

Invaluable though these techniques are, they neither deliver complete certainty nor a permanent solution. Furthermore, ultimate responsibility for the liability will still remain with one or other counter party. A new European environmental liability 'buy out' product – Active Transfer® has recently been launched by WSP Group plc (the global management and consultancy company) which will provide the certainty that every property professional craves.

The Active Transfer model is a refinement of an existing US initiative (called Exit Strategy) which was developed by the leading US remediation company TRC Inc and global insurance broker Willis Group Holdings. The key feature of the Active Transfer® model is to allow companies to 'outsource' or remove environmental liabilities in perpetuity.

This diagram outlines the basic structure of the model (in this case as it might be applied in the context of a property transaction). The liability for pre-existing contamination issues is contractually transferred to WSP, forever, by way of a comprehensive indemnity provision.



The seller thereby achieves a release from his legacy liabilities, to the extent permitted by UK law. This allows the buyer to take the asset without assuming the contamination liabilities.

WSP is contractually obliged to manage the contamination issues and carry out any necessary clean up works. Ownership and control of the asset are retained and long term financial security is achieved through the use of a structured insurance programme arranged by Willis.

The insurance programme, which has been specially developed for Active Transfer®, underpins the contractual risk allocation and can run for up to 30 years. It ensures that funds are available for managing the liability (ie carrying out the remediation) and covers the additional financial uncertainty – thereby providing a further layer of security.

This approach can deliver numerous benefits to buyers, sellers, funders and investors.

A number of formal breakfast presentations have already taken place and more are planned over the next few months. The next two presentations are to be held at Ten Trinity Square at 8.45am on 14th April and 28th April. If you would like to attend either of these sessions or require more information on this exciting new product please contact Mike Balmer.



Residual Value Insurance:

# RVI for Commercial Property



Where's the market at?

**The rumour was unconfirmed but was about as credible as England winning a cricket match. The XYZ insurance company was offering to write RVI up to 90% on selected commercial properties. What made the rumour even less likely was that the insurer in question was barely known for any RVI activities – or indeed for being active in financial risks at all.**

I rang the company. Yes, it was true. They would write 90% RVI on very good properties in central London and some other European capitals. They could do more, namely write 100% of the exposure perhaps. There was, of course, a catch. The company was not really proposing to take this level of risk in a 'toppy' market. They would indeed issue a contract at an elevated level but beneath the surface was a compound policy which brought together a layer of 'finite cover' and some genuine risk transfer. 'Finite' policies work on the principle that the insurer is, to a more or less extent, cash collateralised for their exposure. Any risk transfer is limited to either the timing of any potential claim or the credit risk that may arise if the insured had to deposit additional collateral over a period of years.

As far as risk transfer on commercial properties was concerned, the insurer was taking a conventional position of underwriting approximately 60% of the likely future market value at a premium that represented a small value of the sum exposed. Above that they wanted the Present Value of the exposure – or, if the party paying the premium was credit worthy – then the Present Value generated by successive premium payments over a short period at the start of the lease (say, 3 years). The premium for the risk bearing part of the policy and the 'finite part' of the policy would then be added together to produce a total premium and a seamless policy

Why do it like this? Essentially for two reasons. The insured party (normally the lessee, with a loss payee clause in favour of a financing bank) now has a policy that collateralises any 'bullet' exposure on termination of the lease while simultaneously enabling the insurance premium to be expensed. The policy may look expensive because of the fully collateralised layer but it should be possible to negotiate a return of premium should the risk not occur. In addition the insurance company will be able to grow the deposited collateral offshore – probably more efficiently than the insured could do so for himself.

This RVI approach will have limited application but for certain property investors and lessees it will be valuable.

Apart from this innovation where is the rest of the market? It is essentially 2 tier. A small number of insurers will underwrite to 60 – 70% of forecast value – mostly in urban areas where the insurer feels he has a good appreciation of the factors that will move values. For example, one insurer underwrites commercial properties in London because the company has an asset management arm which routinely invests in property. Much more capacity is available at what is known as accounting level RVI – around 30% of forecast value. This is mostly used where a low level of RVI can transform a capital lease into a finance lease. The object has less to do with risk taking than balance sheet treatment.

The RVI market is always limited. It is not a 'natural' insurance product, because of the way liabilities accumulate, but the capacity has not disappeared and there is always someone who, as in the example above, may be prepared to offer an additional twist of innovation. For further information on RVI please contact Nicholas Millard of Willis Structured Finance Solutions.



# Topics in brief

## An expensive mushroom?

In an out of court settlement a woman who slipped on a mushroom which was lying on the floor of a supermarket has received damages of £550,000. The slip caused injury to her hip, which surgery was unable to cure, and she is now confined to a wheelchair.

While it may have been the largest this is by no means the first successful claim of this type. Claims against supermarkets are constantly being made from slips and have arisen from yoghurt, a squashed tomato, a grape and spilled mineral water.

While such incidents might happen in any workplace they are perhaps most likely to occur in retail outlets, shopping centres, restaurants, and other places which have a high level of public use and in which food, drink and other substances are likely to make a floor slippery if spilled or dropped. These businesses should ensure that appropriate cleaning and maintenance procedures are in place to deal with spills. A finding of negligence is less likely if the operator can show that effective procedures are well established. CCTV evidence can also play a significant role in the repudiation of a claim.

## D & O Newsletter

The Directors and Officers Liability insurance market is currently experiencing a difficult period with demands for increased premiums and cover restrictions commonplace in what is a very specialist market. Global Financial and Executive Risks have recently produced a D&O Newsletter which addresses some of the the issues in this important area. Copies of this newsletter are available on request.

## Damage caused by an uninsured risk

Leases have historically been silent on the issue of apportioning liability between the landlord and the tenant in the event of damage to the demised premises being caused by an uninsured risk. This meant that tenants had no protection if the building was damaged by an uninsured risk and the tenants could potentially find themselves in a position where they could not claim an abatement of rent and may even be obliged to rebuild the premises at their own expense.

Tenants have started to attempt to pass some or all of the liability back to the landlords in lease negotiations and anchor tenants may well have had some success in this respect. The situation improved when Pool Re was established which provided protection against damage caused by terrorist activity. Pool Re was however of no assistance in respect of other uninsured risks such as subsidence but this was not considered to be such a significant problem.

However, tenants' attention has recently begun to turn to this issue again for a number of reasons including:

- wider exclusions being imposed on buildings' insurance policies in relation to damage by terrorist activity
- the approach of the insurance market to the flood risk which means that flooding may increasingly become an uninsured risk in certain areas
- recommendation 8 in the Code of Practice for Commercial Leases which states that "if the premises are damaged by an uninsured risk so as to prevent occupation the tenant shall be allowed to terminate the lease unless the landlord agrees to rebuild at his own cost".

We are now getting to the stage where it will become more usual for tenants to raise the issue of damage by uninsured risks during lease negotiations. With further contraction of the insurance market anticipated over the next few years it is likely to become an even greater problem.

Should you require any advice or assistance in obtaining solutions to your uninsured exposures please contact Doug Bell or Mike Etches.



For further information on any of the articles included in this bulletin please do not hesitate to contact any of the following:

**Mike Balmer**  
Environmental  
Tel: 020 7975 2904  
Fax: 020 7975 2583  
Email: balmerm@willis.com

**Doug Bell**  
Risk Solutions  
Tel: 020 7975 2736  
Fax: 020 7975 2884  
Email: belldz@willis.com

**Mike Etches**  
Risk Solutions  
Tel: 020 7975 2811  
Fax: 020 7975 2583  
Email: etchesme@willis.com

**Nicholas Millard**  
Structured Finance Solutions  
Tel: 020 7975 2144  
Fax: 020 7975 2207  
Email: millardn@willis.com

**Michael Mooney**  
Risk Management  
Tel: 01235 544805  
Fax: 01235 544872  
Email: mooneym@willis.com

Willis Limited  
One Camomile Street, London  
EC3A 7LA  
Telephone: 020 7488 8111  
Fax: 020 7975 2884

This document has been produced for information purposes only. Please note that while we have taken all reasonable care in the preparation of content, we accept no responsibility for its accuracy. A member of the General Insurance Standards Council