

## MARSH INSIGHTS: ENVIRONMENTAL RISK QUARTERLY

The real estate industry has historically seemed immune from environmental risk. But the real estate lifecycle—whether for a single property or a portfolio of properties—encompasses many operations that include environmental risk components.

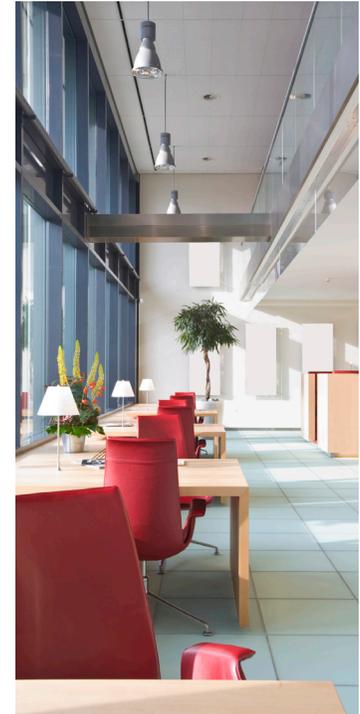
This edition of Marsh's *Environmental Risk Quarterly* will focus on environmental risks in the real estate industry. It should be noted that many of the environmental risks examined here are universal—also affecting such industries as healthcare, retail, and communications, media, and technology.

Portions of the real estate lifecycle in which environmental risk plays a role include:

- property acquisition;
- property financing and investing;
- property development;
- property operation and management; and
- property divestiture.

### PROPERTY ACQUISITION

The primary environmental risk to any entity during property acquisition is the failure to adequately screen one or more properties for environmental liabilities prior to acquisition. But environmental issues may also be discovered despite thorough environmental investigations. When environmental issues are discovered, the costs to clean up pollutants may often exceed the original estimated costs that were addressed in indemnification agreements.



### PROPERTY FINANCING AND INVESTING

Many real estate entities are looking for ways to improve opportunities to borrow from capital markets as a means to continue operations or for project financing. At the same time, lenders have pulled back on offering financing because of higher default rates. In the current economic climate, lenders and investors are now managing growing portfolios of foreclosed properties that may have environmental risk—which could create challenges in assessing exposures within a

real estate portfolio and delay the appropriate “work out.” Environmental risk can limit the ability to monetize foreclosed properties at their maximum values.

## PROPERTY DEVELOPMENT

A chief exposure of real estate entities during property development is from contractors or professionals, who could be inadequately insured for environmental releases during construction activities on-site. Another significant environmental exposure during redevelopment projects is the potential to discover unknown pollutants or incur greater costs than originally anticipated to address known pollutants.

## PROPERTY OPERATION AND MANAGEMENT

Chemicals emitted from building operations can affect third parties, such as contracted management companies, dry cleaning establishments, and asbestos/lead abatement projects. Residual contamination from minor spills of maintenance products—including oils, fuels, and lubricants—could affect a property’s soil or groundwater. Indoor air quality exposure, such as mold or legionella can affect third party tenants or guests. Though it has not generated much publicity, claims are still being tendered to environmental insurers regularly for mold and legionella.

## PROPERTY DIVESTITURE

Buyers today are looking more closely at environmental risk issues and conditions at properties and have a much lower environmental risk tolerance. Problems, such as time limits or gaps in liability protection, with indemnification agreements, typically used to address environmental concerns during the purchase of real estate, can ensue. Sellers may be subject to counterparty credit risk if there is a “failure to perform” with respect to their indemnity obligations.

## RECENT REAL ESTATE CLAIMS ACTIVITY

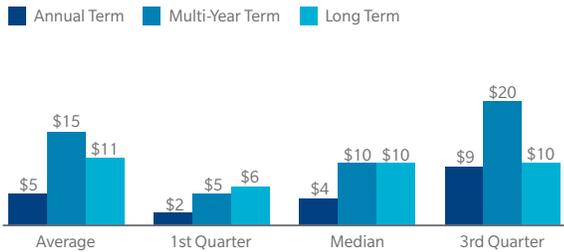
The Marsh Environmental Practice monitors environmental claims activity on a regular basis. The following are a few significant recent claims affecting real estate entities:

- A federal court recently ruled that a property management company would not be covered under its general liability policy for claims against the company alleging that it hired a landscaping company at a golf course that contaminated the area with a toxic herbicide. The claim was denied because of a pollution exclusion in the management company’s general liability policy.
- A homebuilder was ordered by environmental regulators to pay a civil penalty of \$625,000 to resolve alleged Clean Water Act violations at its construction sites. The company was also ordered to conduct inspections of its construction sites to minimize future runoff from those sites.
- A real estate client of an environmental insurer was involved in a mechanical failure of the controls of an elevator car which caused a capacitor to explode, dispersing oil containing polychlorinated biphenyls (PCBs) in the immediate vicinity. One commercial tenant was evacuated. The environmental insurer paid in excess of \$100,000 to resolve the claim.

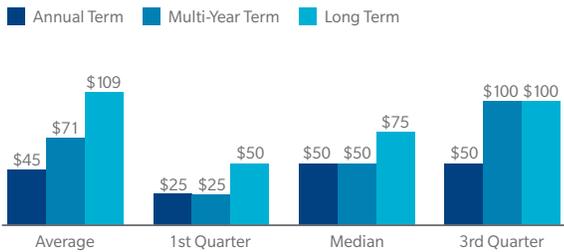
## ENVIRONMENTAL INSURANCE SOLUTIONS

Environmental insurers have products that can specifically address the environmental risks that stem from every phase of the real estate lifecycle. These products can be designed to provide coverage for one property or for a portfolio of properties. In some instances, portfolios can be categorized and priced according to their risk profiles and premium caps can be placed on future premiums for similar categorized sites. In addition, programs can be designed to offer premium relief for properties taken out of a portfolio of sites or to offer premium certainty for properties that will be rolled into an existing portfolio.

### Total Aggregate Limits (\$Millions) - 66 Peers

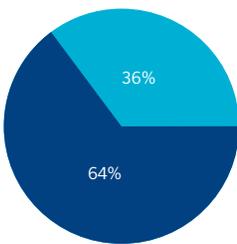


### Deductibles/Retentions (\$Thousands) - 66 Peers



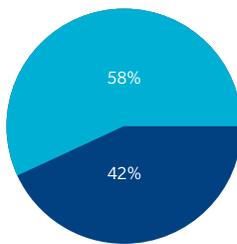
Over the last two years, average limits for real estate entities, including property owners and developers, have averaged \$5,000 for single-year policies and \$15,000 for multi-year policies. Average deductibles have ranged from \$45,000 to \$109,000. Most Marsh clients (more than 60 percent) purchased mold coverage as part of their real estate environmental risk management programs and many clients (more than 40 percent) purchased terrorism coverage. In addition, most real estate entities (more than 65 percent) purchased coverage for non-owned disposal sites.<sup>1</sup>

#### % of Peers Purchased Mold Coverage



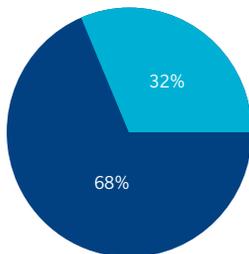
■ Yes ■ No

#### % of Peers Purchased Terrorism Coverage



■ Yes ■ No

#### % of Peers Purchased Non-owned Disposal Site Coverage



■ Yes ■ No

<sup>1</sup> Source: Marsh's Global Benchmarking Portal

# ENVIRONMENTAL INSURANCE RESPONDS TO LEGIONNAIRES CLAIMS

What would a recent party at the Playboy Mansion in 2011, a gathering in 2002 at an arts center in the United Kingdom, and a Legionnaires' convention that took place more than 30 years ago in Philadelphia have in common? No, not the same menu, activities or décor—but one common uninvited guest: the bacterium *Legionella pneumophila*, which caused illness and, in some cases, death.

## HOW DOES LEGIONELLA MANIFEST AND SPREAD?

*Legionella pneumophila* causes what has now come to have been called Legionnaires' disease. Victims are typically infected through inhalation of very small (aerosol) particles containing the bacteria. These particles can originate from any water source that has been infected, including cooling waters, large plumbing systems, air conditioning systems, evaporative coolers, nebulizers, humidifiers, whirlpools, hot water systems, showers, room-air humidifiers, ice making misting equipment, and even windshield washers. *Legionella* has been found both in people that were very close to infected water sources and others that were miles away—one of the reasons why investigating the source and pathway of an infected population is often so difficult.

The most common cause of a *Legionella* outbreak has been found to be a lack of maintenance of a facility's water system. The potential for transmission of the disease is greatest in areas of high population or where large amounts of people congregate.

According to the New York City Department of Health, between 8,000<sup>2</sup> and 18,000 people report developing legionnaire's disease in the United States annually, with more infections not being reported because of mild symptoms. A recent rash of legionnaire's disease in a number of states has been linked to stagnant water in cooling towers.

## ENVIRONMENTAL INSURANCE SOLUTIONS

Environmental insurers now have products that will respond to claims against real estate entities for exposure to the *Legionella* bacterium. Clients often believe that their companies will be protected against these types of claims under their general liability or property policies or by water system maintenance plans that they have instituted. However, in Marsh's experience, standard insurance policies and water system maintenance plans may not be enough to respond to *Legionella* claims against real estate clients.

Due to the current highly competitive marketplace for environmental insurance, it is now possible to obtain coverage for *Legionella* claims, including coverage for investigation, cleanup and restoration costs. These policies can offer additional protection against third party bodily injury, property damage claims, and business interruption.

<sup>2</sup> <http://www.nyc.gov/html/doh/html/cd/cdlegi.shtml>

## COST CAP UPDATE

The environmental insurance marketplace has expanded over the last five years, resulting in greater availability of environmental insurance offerings and broader coverage. But one environmental insurance product that is no longer being offered by any of the primary environmental insurers is the stop loss or cost cap. Cost cap was designed to respond to cost overruns at sites requiring cleanup of known pollutants.

In September, Zurich followed Chartis, ACE, and XL in exiting this product line, citing unacceptable loss ratios. These carriers will likely remain out of the market well into 2012 and have said they may consider re-entry in the future as they reassess the product and their ability to underwrite in a sustainable manner.

Marsh is in continued discussions with the broader insurance marketplace about solutions to meet these important needs. For now, there are a number of other risk management alternatives that may be applicable depending on specific needs on insureds, including:

- self-insurance of known conditions in conjunction with pollution legal liability insurance (PLL), which can be used to address unknown pre-existing conditions, de minimis known conditions, regulatory reopeners, and counter-party credit risk;
- fronted insurance, where evidence of insurance is the primary driver;
- assumption of known environmental risks by a liability buyout company, paired with PLL excess of indemnity coverage to back up the liability buyout company's obligation; and
- single entity captives for multi-risk, programmatic approaches.

## WHY MARSH FOR YOUR RISK MANAGEMENT NEEDS?

Environmental risk can have serious negative effects on an organization's financial wellbeing, hampering its ability to achieve business objectives domestically or globally. Existing and forthcoming environmental legislation and regulations, emerging risks, and liability trends can all influence an organization's financial performance, reputation and brand, cash flow, and shareholder value.

For more than a decade, Marsh has been the recognized leading producer of environmental insurance. Over the past five years, we have placed approximately \$850 million in environmental premium by bringing global expertise to local issues affecting our clients.

The experience our professionals have gained advising thousands of clients have reinforced our understanding of the need to bring a multidisciplinary approach to solving environmental risk issues.

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