

Representations & Warranties Insurance Complex Real Estate Transactions

Why Purchase a Real Estate R&W Policy

- Representations & Warranties Insurance covers loss incurred as a result of the inaccuracy or breach of reps and warranties or crystallization of exposures covered under an indemnity (such as a tax or other specific indemnity).
- Can be used to enhance, supplement or replace some or all of a sellers indemnification obligation.
- Real estate transactions often have limited recourse “as is, where is”
- Types of Real Estate Transactions
 - Asset sale of Real Property
 - Stock sale of entity which owns real property
 - REIT Transactions
 - Portfolio Asset Transactions

Buyer v. Seller Policy

- Buyer Policy: First party indemnity policy structure – covers loss resulting from breaches discovered during the policy term
 - Can extend survival periods beyond acquisition agreement (can be tailored to meet needs of parties out to as long as 6 years)
 - Can increase indemnification above seller indemnification cap
 - Distinguish a bid in an auction
- Seller Policy: Liability policy structure – covers claims made against the sellers alleging breach of representations and warranties
 - Generally follows caps and survival periods in acquisition agreements (to maximum of 6 years)
 - Protect Sellers and expedite distribution of sale proceeds

R&W Insurance – Basics

- All representations and warranties generally are included in coverage including tax matters and environmental.
- Pricing
 - Generally 2% to 4% of the limit of liability – (i.e. \$200,000 to \$400,000 per \$10 million of indemnity protection)
- Policy period
 - Typically matches survival period in acquisition agreement (up to 6 years) or extends survival period up to 6 years
- Retention
 - Minimum 1% to 2% of the transaction value
 - Typically drops down as escrow is released to a minimal retention level of between .5% and 1% of purchase price)
- Underwriting Considerations
 - Items not covered: forward looking statements and projections, covenants (can be considered in some situations), known or disclosed items (may be addressed via a separate contingency policy), asbestos
 - Due diligence

Underwriting Process

- Broker
- Account Clearance/Execution of Non-Disclosure Agreements
- Provision of Underwriting Submission
 - Required information includes: draft purchase agreement, draft disclosures, financials of target
- Non-binding Indication within 2 - 3 days
 - No cost to obtain conceptual proposal
- Payment of Underwriting Fee
 - Fees range from \$10K - \$30K (depending on nature and complexity of risk).
- Underwriting Process: 5 – 10 days
 - High level review of diligence process (if Buyer Side) or disclosure process (if Seller Side)
 - Access to legal, financial tax and other DD reports (if Buyer Side)
 - Underwriting calls with Proposed Insured's deal team and advisors
- Policy Negotiations
 - Concurrent with underwriting process
 - Impact on transaction agreement terms
 - Representations Letter

R&W Policy Negotiations

- Typically, the policy is conformed with the terms and conditions set out in the underlying transaction agreement.
- Policies are negotiable
- Key Terms
 - Claims made coverage (when Breach is discovered)
 - Survival Period, Policy Period
 - Limit of Liability
 - Retention (dropping over time)
 - Representations Letter

Key R&W Policy Terms

- **Definitions**

- Covered R&W
- Covered Loss (damages, taxes, covered costs/legal costs)

- **Exclusions**

- Known existing Breach
- Projections or estimates
- Purchase price adjustments
- Physical condition of property
- Title defects
- Non-monetary relief

- **Miscellaneous Terms**

- Mandatory ADR
- Inadvertent Policy breach
- Loss payee

Current Trends

- Auction Process
 - Buyer's distinguish a bid in an auction process
 - Sellers seeking quotes pre-bidding and including R&W insurance as sole remedy in draft purchase agreements
- Lender driven
- REIT Transactions
- Sophisticated Brokers
- Law firms have pre-negotiated forms