BLOG

Not All Insurance is a Deficit: Environmental Protection Can Make You Money

By Joe Quarantello

Oct 8, 2018

Let's face it. Insurance is something that no one wants to buy, no one wants to use, and no one wants to keep renewing. We buy it because we have to, because not having it means risking everything. While most types of insurance -- from health to cyber, from professional to private equity -- are considered losses on a balance sheet, environmental insurance products are unique because they can actually be an asset in the sale of a property.

How does insurance move from the red to the black on a balance sheet?

As we talked about recently, the cradle-to-grave nature of environmental liability has a profound impact on the buyer or seller of any property in a transaction.

According to local, state and federal statutes, if you own a property and regulators find it to be contaminated, you could assume all its environmental risk and you can be forced into costly remediation projects **at any time**. Even sites that sit dormant for years can create clean-up nightmares for owners down the road.

There are a million ways in which sites become contaminated. Natural disasters. Centuries' old industrial waste. Run-off from an abutting property. Fly ash waste streams from decommissioned power plants.

And there are just as many ways regulators can require owners to remediate through active measures and fines. Did you know, for example, that natural resource claims can require owners to pay for the cost associated with different species of birds, for every bird deemed to be affected by contamination of a site? It's not just birds. Statistical models calculate factors like spawning habits when assessing loss in fish populations, and the cost of replacing stress vegetation.

But I digress.

Because of the long tail of environmental liability, banks and lenders are often hesitant to give loans to real estate developers. In the event of default, a lender is hesitant to foreclose and become a potential responsible party. In addition to the lender's concern, pre-existing environmental conditions can be a dealbreaker because buyers require a holdback in cash from the seller to cover potential environmental issues down the road. Sellers have to put up some type of guarantee such as establishing an escrow to cover costs when regulators open or reopen investigations.

However, environmental insurance products can be transferred from seller to buyer in a transaction as a protection against possible property problems. This helps alleviate the cash-flow issues, eliminates frictional costs, and smooths out the sale. The policy then becomes an asset to the new buyer when it’s time for them to sell.

We recently worked with a family trust who invested in a commercial property that went bankrupt. The trust ended up with the property because one of the members in the trust was the primary investor, but he was concerned about a regulatory reopener since the site had historical environmental problems. The trust bought a pollution legal liability program which we engineered to cover remediation, legal defense, bodily injury, and even matters such as removal of materials to non-owned landfills. He was able to sell the property partly because he could transfer the policy we created.

Environmental insurance is not a one-size-fits-all product and must be written for each specific case. It’s a unique product that requires the policy language to be manuscripted to meet the obligations of the transaction.

For help in turning your environmental liability into a transactional asset, contact jquarantello@risk-strategies.com.

TAGS:
Environmental