



# Reps & Warranties / Transactional Liability Insurance Services for Commercial Real Estate Transactions



# Representations & Warranties- Overview

Overview - Protects a party from financial losses resulting from inaccuracies in the representations and warranties made in the Purchase and Sale Agreement (“PSA”):

- Introduced to the U.S. market in 1998; however, it was not until 2014 that the product started to be used on a frequent basis on traditional M&A transactions and recently has become more widely used in commercial real estate transactions
- Types of Policies – Buyer-Side or Seller-Side (95%+ of policies are Buyer-Side – The Buyer controls the placement of the policy but the premium can be split between Buyer and Seller)



# Representations & Warranties- Real Estate Investment

Representations and Warranties Insurance allows clients to focus on core capabilities of leasing, financing, developing and constructing world class assets. RWI leverages insurance capital to provide an indemnity backstop to transactions. Target deal size is \$50 million plus, but carriers will consider smaller deals especially for “serial acquirors”.

Examples of business sectors that insurance capital is used to help facilitate include:

- Single and Multi Family Residential
- Retail and Shopping Malls
- Warehouses and logistics
- Office
- Cell Towers
- Student Housing
- Schools and Universities
- Long Term Care Homes
- Undeveloped Land

# Representations & Warranties- Sample Covered Representations

- Financials/rent roll/leases
- Material contracts
- Litigation
- Title
- Condition of Assets
- Capitalization
- Compliance with laws/Regulatory
- Synthetic
  - Representations that the Seller may not be willing to make in the PSA but the carrier may be willing to include synthetically in the policy assuming the appropriate diligence is done (i.e. environmental, rent roll, etc.).

# Representations & Warranties- Product Highlights

Amount of Coverage	Premiums	Retention (Deductible)	Policy Period	Carriers	MGAs
<p>Typical limit of liability purchased is 10%-15% of the purchase price</p> <p>Several primary carriers can offer up to \$50M in limits on a single transaction</p>	<p>Generally 1.3% to 2.1% of the limit of liability (“ROL”) (e.g. \$10 million limit for \$150,000 (1.5% ROL))</p> <p>Minimum premiums vary by carrier (\$50K plus)</p>	<p>.1% to .5% of the Purchase Price (with minimums);</p>	<p>3 years for General Reps and 6 years for Fundamental Reps and Tax for a Buy-Side Policy</p> <p>Matches transaction agreement indemnity survival period (up to 6 years) for a Sell-Side Policy;</p>	<p>AIG, AWAC, Beazley (Lloyds), Ironshore, Chubb, Hartford, RLI, QBE, Everest, XL, Berkley Pro, Berkshire, Ironshore, XL, CFC, HCC and Great American</p>	<p>Ambridge, DUAL, Concord Specialty, VALE, BlueChip, ETHOS, ASQ, VALE, Mosaic, RP and Euclid Transactional</p>

# Representations & Warranties- Purchase Rationale/Key Benefits

## Buyer

- Supplement or replace indemnity amount provided by Sellers
- Extend survival period of representations and warranties provided by Seller
- Elimination of seller post-closing credit risk
- Gives a competitive edge in the case of multiple offers
- Avoid potentially significant claims against the Selling company's management team
- Achieve indemnity where otherwise unavailable (e.g. public-to-private, bankruptcy/distressed, or "as-is, where is" deal)



## Seller

- Avoid exposure to significant post-closing indemnity payments
- Lock-in proceeds from sale for faster distribution to investors and/or creditors
- Replace or reduce escrow amounts post-closing
- Protect passive sellers
- Minimizes having to claw-back funds from investors



# Representations & Warranties Insurance- Process and Timeline

## Phase 1 of the Process



- Send initial submission to carriers
  - Draft PSA
  - LOI
  - Rent roll/Leases (if available)
  - Title, easements, permits, and zoning reports (if available)
  - Environmental matters including Phase I reports (if available)
  - Property condition reports (if available)
  - Tax matters relating to the corporate entity (if applicable)
- Obtain Non-binding indication(s) (NBIL) from carrier(s) (3-5 business days)

# Representations & Warranties Insurance- Process and Timeline

## Phase 2 of the Process



- Select primary carrier and pay underwriting fee (\$25K-\$50K) to cover carrier's outside advisor and consultant costs (e.g., legal, tax, environmental)
- Provide the carriers and its counsel access to the data room (if available)
- Have the carrier execute a Non-Reliance Letter from each advisor or consultant that will require one so their report can be shared with the underwriter
- Set up an underwriting call with the carrier, its counsel, the deal team members and their 3rd party diligence providers; (for asset deal carrier may only require a questionnaire in lieu of an underwriting call (**see Annex A**):
  - The call is set up 48 hours after the carrier has received a copy of all of the Buyer's due diligence reports and draft copy of the Disclosure Schedules
  - The call will generally last about 1 to 2 hours; the deal team, its counsel (corporate) and RS will be on the entire call; the specialists only have to dial in for their section which will last about 15 minutes
  - The underwriter will usually provide the agenda 24 to 48 hours prior to the call;
    - Some carriers will only provide a high level agenda and others will provide a list of detailed questions
    - Some carriers will have their counsel on the call and others it will just be the underwriter
- Provide the carrier responses to any additional follow up questions and requests from the underwriting call
- Continue to send the underwriter updates to the draft of the PSA and Disclosure Schedules until final
- Policy negotiation (concurrent with underwriting process)



# Representations & Warranties Insurance- Exclusions

## Standard Exclusions

- Material inaccuracy in the No Claims Declarations\* (“NCD”)
- Actual Knowledge of the top two or three principles of the Buyer
- Breach of covenants
- Asbestos or Polychlorinated Biphenyls
- Specific/Special indemnity relating to known risk (if applicable)

\*The NCD is executed by the Buyer at closing. It is attached to the policy and includes provisions such as:

- i. the Buyer is not aware of any Breaches of Representations or Warranties in the PSA
- ii. the Buyer has provided the Insurer with its diligence reports



# Representations & Warranties Insurance- Key Provisions

## Definitions

- Actual Knowledge
- Losses/Damages
- Defense Costs
- Pre-Closing Tax Indemnity (if applicable)
- Breach
- Deal Team Members

## Subrogation

- No subrogation against Buyer
- Subrogation against Sellers is limited to fraud (if reasonable, carriers will follow the definition of Fraud in the Agreement)

# Representations & Warranties Insurance- Claims

## Reporting a Claim

- Follow the language in the insurance policy
- Report circumstances that may rise into a Claim
- Do not incur Defense Costs without the consent of the Insurer (although there is usually a set amount in the policy that the Insured can incur without the consent of the Insurer)
- Do not settle a Claim without the consent of the Insurer

## Common Claims

- Material Contracts
- Leases
- Tax
- Compliance with laws
- Title Risks
- Condition of Assets
- Litigation (3rd party Claims)
- Environmental

# To Learn More Contact:

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Jeff joined Risk Strategies as a Senior Managing Director of the company's Executive Liability Practice out of Chicago. His primary objective is to work closely with RSC's clients to assist them with their placement of a variety of Transactional Liability products, including but not limited to Representations & Warranties, Tax Liability and Contingent Liability. Jeff has extensive experience in manuscripting language of insurance policies to address the specific needs of each of his clients and also working with his clients on complex claim matters. He has sat on multiple advisory boards and panels and is considered one of the prominent leaders in the Transactional Liability industry. Prior to joining RSC, Jeff was Senior Vice President, at Equity Risk Partners and was in charge of their FinTran unit (Executive Liability Department) for over six years. Before working for Equity Risk Partners, Jeff held the position of Senior Vice President in Marsh's FINPRO unit and was there for over eight years. Prior to Marsh he was an underwriter for Chubb in their Executive Liability department and CNA in their HealthPro department. Jeff began his career as a Trading Assistant in the Euro-Dollar trading option pit at the Chicago Mercantile Exchange before transitioning to insurance. Jeff holds a B.A. in Economics from the University of Pennsylvania.



## Underwriting Questionnaire – Project [XXXXXXXXXXXX]

Please respond to the following underwriting questions in writing. Please advise the name and position of the individual(s) responding to each question. The following terms have their corresponding meanings:

- (i)“Agreement” means the [sale and purchase agreement] by and between each of [Seller] (“Seller”) and [Buyer] (“Buyer”), dated [ ], 202[ ]
- (ii)“The Transaction” means the transaction to acquire the [Property/Properties] (as such terms are defined in the Agreement) by the Buyer from the Seller.
- (iii)All other capitalized terms have the meanings assigned to them in the Agreement unless stated otherwise.

### Underwriting Questions – General

No.	Question	Answer
1	Please provide us with a copy of the disclosure schedules relating to the Agreement.	Responder
2	Please state all advisers engaged by you in respect of this transaction, their role and whether they have prepared any diligence reports or advice in connection with the Transaction. Please provide copies of any written diligence reports prepared by such advisers (to the extent not already provided).	Responder
3	Please confirm if any further planned diligence remains to be completed between signing and closing.	Responder
4	Are there any liens, leases, easement, municipal violations, or other issues that could encumber any of the [Property/Properties]?	Responder

# Representations & Warranties Insurance -

## Annex A

No.	Question	Answer
5	Please provide us with a copy of the disclosure schedules relating to the Agreement.	Responder
6	Please state all advisers engaged by you in respect of this transaction, their role and whether they have prepared any diligence reports or advice in connection with the Transaction. Please provide copies of any written diligence reports prepared by such advisers (to the extent not already provided).	Responder
7	Please confirm if any further planned diligence remains to be completed between signing and closing.	Responder
8	Are there any liens, leases, easement, municipal violations, or other issues that could encumber any of the [Property/Properties]?	Responder
9	Did you or Seller commission Phase Is for the [Property/Properties] in last 12 months? Were any RECs, HRECs, CRECs or other environmental concerns identified? Please provide further details of any Phase II Tests undertaken, including a summary of the findings thereof.	Responder
10	What litigation, lien and bankruptcy searches have / will you conduct (please include state and federal jurisdictions)? Please summarize the results of such searches. Are all results adequately reflected in the Disclosure Schedules to the Agreement?	Responder
11	Has the Seller disclosed to you (either in the Disclosure Schedules to the Agreement or otherwise) any notices of violation of any laws affecting any of the [Property/Properties]?	Responder
12	Have you or Seller commissioned PZR or zoning reports in the last 12 months in relation to each of the Properties? Did the report identify any material zoning violations which will not be corrected by closing? Please provide details or any open building, fire or other code violations or a copy of the PZR or zoning reports for each Property.	Responder
13	Please confirm how you are satisfied that there are no pending or threatened condemnation or eminent domain proceedings in relation to the [Property/Properties].	Responder

# Representations & Warranties Insurance -

## Annex A

No.	Question	Answer
14	Please confirm how you are satisfied that there are no special assessments, impositions, increases in assessed valuations or other tax contests pending or threatened relating to the [Property/Properties].	Responder
15	Have you reviewed any ongoing capital projects of the Seller currently in progress affecting the [Property/Properties]? Please describe how you are satisfied that no outstanding amounts remain unpaid with respect to such projects.	Responder
16	Has Seller waived any option, right of first refusal, right of first offer or other unrecorded right to purchase or any other preferential rights over or in respect of the [Property/Properties] or otherwise? Have any such instruments or rights expired to your knowledge?	Responder
17	Please confirm there are no employees within the transaction perimeter?	Responder
18	Have you interviewed on-site management of the [Property/Properties]? If yes, have any responses resulted in any of the following:- <ul style="list-style-type: none"> <li>• Purchase price adjustment</li> <li>• Provision for increase in expenses or liabilities</li> <li>• Additional due diligence</li> <li>• Request for further information from the Seller?</li> </ul>	Responder
19	Please describe any diligence undertaken to confirm that the Seller and its direct and indirect owners are in compliance with the requirements of OFAC and the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001. Were independent searches conducted and if so please summarize the results thereof?	Responder
20	How have you been made comfortable that there is no tax exposures relating to the [Property/Properties]?	Responder

No.	Question	Answer
21	<p><b>Rent Roll</b> The following questions relate to your diligence of the rent roll.</p> <p>a) Please describe your diligence undertaken in respect of the Rent Roll (“Rent Roll Review” or “RRR”).</p> <p>b) How many leases were reviewed as part of your RRR?</p> <p>c) Are all leases standard? If not, what is the extent of deviation?</p> <p>d) Have you reviewed whether the leases comply with all applicable local, state and federal laws?</p> <p>e) Did your RRR reconcile individual leases to the general ledger (including any rental concessions, commissions and instances of financial hardship and actions resulting therefrom)?</p> <p>f) Does the Rent Roll summarize:</p> <ul style="list-style-type: none"> <li>(iv)key tenant lease terms</li> <li>(v)tenant names</li> <li>(vi)contact information</li> <li>(vii)rent payable</li> <li>(viii)periodic rental rate increases</li> <li>(ix)lease structure (e.g., triple net or gross)</li> <li>(x)term or duration of the lease</li> </ul> <p>Please respond by exception.</p>	Responder



No.	Question	Answer
21	<p><b>Rent Roll</b> The following questions relate to your diligence of the rent roll.</p> <p>g) Did you review security deposits as part of your RRR?</p> <p>h) Are any of the following issues terms of or regulated pursuant to any the leases of the [Property/Properties]?</p> <ul style="list-style-type: none"> <li>(i) Tenant improvements, landlord obligations</li> <li>(ii) Use restrictions and noncompete provisions</li> <li>(iii) Renewal/expansion options</li> <li>(iv) Early termination clauses</li> <li>(v) Purchase options and rights of first refusal</li> <li>(vi) Continued operation: “go dark” provisions</li> <li>(vii) Co-tenancy provisions</li> <li>(viii) Parking requirements</li> <li>(ix) Assignment and subletting</li> </ul> <p>Subordination, non-disturbance, and attornment</p> <p>i) Are there any other sources of income other than from the Rent Roll?</p> <p>j) What is your view regarding the current vacancy rate of the [Property/Properties]?</p> <p>k) Did you identify any side agreements or undocumented agreements amending any key terms of leases?</p>	Responder