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PROPERTY & CASUALTY

Benefits Of Representations And Warranty Insurance (RWI) In Real Estate Transactions

Overview

Traditional real estate industry solutions for allocating risk (e.g., guarantees, holdbacks or escrows) are insufficient or uneconomic for real estate transactions. Representations and warranty insurance (RWI) helps alleviate concerns regarding a seller's creditworthiness by replacing or supplementing the seller's indemnity with a highly rated insurer responsible for payment of any losses resulting from a breach of the representations and warranties in the purchase agreement.

Improved Recourse for Buyers

Policies typically include an initial retention of 0.25% of the enterprise value (EV), which is reduced to 0.1% of the EV 12 months after the policy's inception. The challenge is that this structure still requires a holdback from the seller, even if minimal. Many carriers are willing to offer a nil ($0) retention by employing a de minimis per claim threshold instead on certain transactions. The de minimis threshold would be set based on the deal's EV and the characteristics of the underlying real property asset(s).

RWI has the added benefit of providing a longer survival period for the representations than typical for uninsured transactions. In contrast to the typical 6-12 month survival period offered by sellers in uninsured transactions, with RWI, general representations survive for three years, and fundamental representations and tax representations/ indemnities last for six years.

Another advantage is that higher limits for indemnification coverage are available with RWI compared to a typical seller's contractually capped indemnity obligation. There is over $1B of total capacity in the RWI insurance market available for any transaction, and RWI can act as excess coverage for title insurance.

Eases Negotiations

Since RWI limits sellers' potential liability, sellers often feel comfortable making broader representations than typical in a real estate transaction (e.g., dealing with an environmental condition for a distinct property). A nil retention structure allows a seller to have a clean exit while still providing the buyer with meaningful protection in the event of a breach of representation, thus easing the negotiation process. Offering this unique nil retention structure can be advantageous for the buyer in a competitive process.

Relationship with Seller

When the buyer plans to continue a business relationship with the seller (i.e., future acquisitions), RWI helps maintain an amicable relationship since indemnification claims are brought against the insurance carrier instead of the seller.

Entity Acquisitions

The representations given in an acquisition of an operating entity are generally more akin to typical “M&A-style” representations, making them broader than in traditional real estate asset acquisitions and increasing the chance of a breach by sellers. RWI generally provides coverage for this broader set of representations that a traditional real estate buyer may not regularly encounter. In these situations, sellers may not be comfortable standing behind those representations. Certain representations may focus on allocating risk for unknown risks, and RWI can help protect against these unknown liabilities.

Tax Insurance

Tax insurance can be used in conjunction with RWI in many situations. This is particularly the case when the customer is acquiring or investing in a real estate investment trust (REIT). Tax insurance can help ensure against the risk that the entity has not been properly classified as a REIT, providing protection against any potential federal income tax exposure. Tax insurance can also mitigate the risk of any known tax issues and backstop any indemnity obligations relating to such risks.

Pricing

Limits	$5M - <$1B
Premium (ROL%)	1.8% - 2.5% of limit placed
Initial Retention	~0.25% of Purchase Price or *nil* (please see above)
Underwriting / Diligence Fee	$25,000 - $45,000
Policy Period	6 years

How Brown & Brown Can Help

Connect with our Brown & Brown team to learn about our knowledge in your industry, how we build our risk mitigation strategies and how we can aid your business in building a cost-saving program.

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