EDITION 1. 2020

REALTALK

A SPECIALIST RISK PUBLICATION FOR THE REAL ESTATE SECTOR

FEATURE ARTICLES

REAL ESTATE MARKET UPDATE

How are insurers protecting themselves against COVID-19 exposure?

OUR NEW REAL ESTATE DUE DILIGENCE PRACTICE

Get to know our advisory service for Real Estate lenders

AN ENVIRONMENTALLY FRIENDLIER SOLUTION

What are the insurance implications of engineered timber?

Gallagher

Insurance | Risk Management | Consulting

ABOUT GALLAGHER

Founded by Arthur Gallagher in Chicago in 1927, Gallagher has grown to become one of the largest insurance brokerage, risk management, and human capital consultant companies in the world. With significant reach internationally, the group employs over 33,000 people and its global network provides services in more than 150 countries.

Gallagher's London divisions offer specialist insurance and risk management services. We provide bespoke policy wordings, programme design and risk placement solutions, and consulting support across a range of specialisms. We manage complex, large, global risks on a direct and wholesale basis and serve as primary access point to Lloyd's of London, London company markets, and international insurance markets.

**WE HELP BUSINESSES GO BEYOND THEIR GOALS.
IT'S THE GALLAGHER WAY.**

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INSIDE THIS EDITION...

EXECUTIVE FOREWORD

A warm welcome to the first edition of our new specialist risk Real Estate publication – "Real Talk."

This publication has been designed to bring you in-depth, relevant content on all areas of the vast world of Real Estate and insurance – from transactional issues, to tenancy troubles, and everything in-between.

Within this issue, we review the current insurance market conditions for the UK Real Estate industry. Although our update is overshadowed by the impacts of the global COVID-19 pandemic, we remain optimistic for the Real Estate industry's future and continue to have every confidence that it will come out of this year stronger and having learnt valuable lessons along the way.

Our focus will always be on stepping up to support our clients and prospects providing guidance on COVID-19 related issues together with advice in achieving their risk and insurance objectives in respect of existing and tenders for new projects.

We have collaborated with specialists within Gallagher, as well as external contributors, to bring a wide range of articles about the diverse risks faced by the Real Estate industry and some of the insurance solutions available.

Over the last few months, the specialist Gallagher Real Estate team has continued to grow. Our lenders Due Diligence team is now established and we have also seen expansion and growth within our M&A team.

As the insurance market changes it will be the quality of our team and the depth of our knowledge which allows us to differentiate from our peers and deliver the results our clients expect.

On behalf of the almost 50 strong team here at Gallagher, a big thank you for taking the time to read this. We hope you find the content both interesting and informative, and please do not hesitate to get in touch.

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ABOUT REAL ESTATE

Our Real Estate team works with clients to realise the advantages to be gained from managing risk more strategically. From helping our clients to understand their total cost of risk across a range of commercial and residential asset classes, to eliminating long-tail risk from the purchase or sale of property, we free up capital for the next commercial opportunity.

Real Estate Snapshot

Dedicated Real Estate Transactional Risks, Legal Indemnities and Due Diligence specialisms which include Warranty & Indemnity and Legal Indemnities

Our Real Estate assets span across **20+** countries from South America to Europe and Asia

Largest Real Estate broker in the UK by premium placement

Over **£500bn** of insured values

correct as of 16 September 2020

01.REAL ESTATE MARKET UPDATE

Since issuing our Q1 Real Estate market update in April 2020, it would be fair to say that things have continued to change at a significant rate. The hardening market that we saw developing in Q4 2019 and Q1 2020 has continued, and has undoubtedly been exacerbated by the COVID-19 pandemic. Whilst it may take until the end of 2020 or even early 2021 for insurers to fully understand their pandemic exposures, insurers have already implemented remedial action to protect themselves. This comes in the form of COVID-19 exclusions to policy wordings as an absolute minimum. Some go as far as a complete communicable disease exclusion.

Aside from communicable disease exclusions, another trend we are seeing is most insurers' reluctance to quote on new business. Whilst the market has generally reacted sensibly when addressing renewals, particularly where longstanding relationships have been built, many are currently focussed on their bottom line rather than top line. That being said, we are already seeing new insurers enter the Real Estate arena, which should help drive competition with established markets. Now more than ever, we are advising our clients to engage with us at least three months prior to renewal, in order to establish a clear strategy for both renewal and the longer term.

One area of the insurance market that appears to be bucking the wider trend is the transactional risks space. Warranty & Indemnity insurers are continuing to spring up, and often employing well established tax and Mergers & Acquisitions (M&A) lawyers as they see this as an area of continued growth. As a result, risks that were not insurable even twelve months ago are now being considered, and new products continue to be introduced. The message to our clients in this area is simple; if you have an identified risk during a transaction, whatever it is, talk to us about it.

Finally, it would be remiss of us not to mention claims. We continue to work proactively with our clients and insurers on some significant COVID-19 related exposures, whilst also watching with keen interest for the outcome of the FCA's Business Interruption test case. It is common knowledge that there are an enormous number of outstanding claims notifications and actual claims in the market at present relating to COVID-19. Much will be decided upon the FCA case verdict. In the meantime, we are working with our customers to help formulate robust positions in the background, helping to push for a favourable outcome.

2020 will undoubtedly be one of the more turbulent years in living history for both the world and the insurance market. The London market, however, has been in existence for over 350 years due to its resilience and ability to adapt. We continue to have every confidence that it will come out of this year stronger and having learnt valuable lessons along the way.

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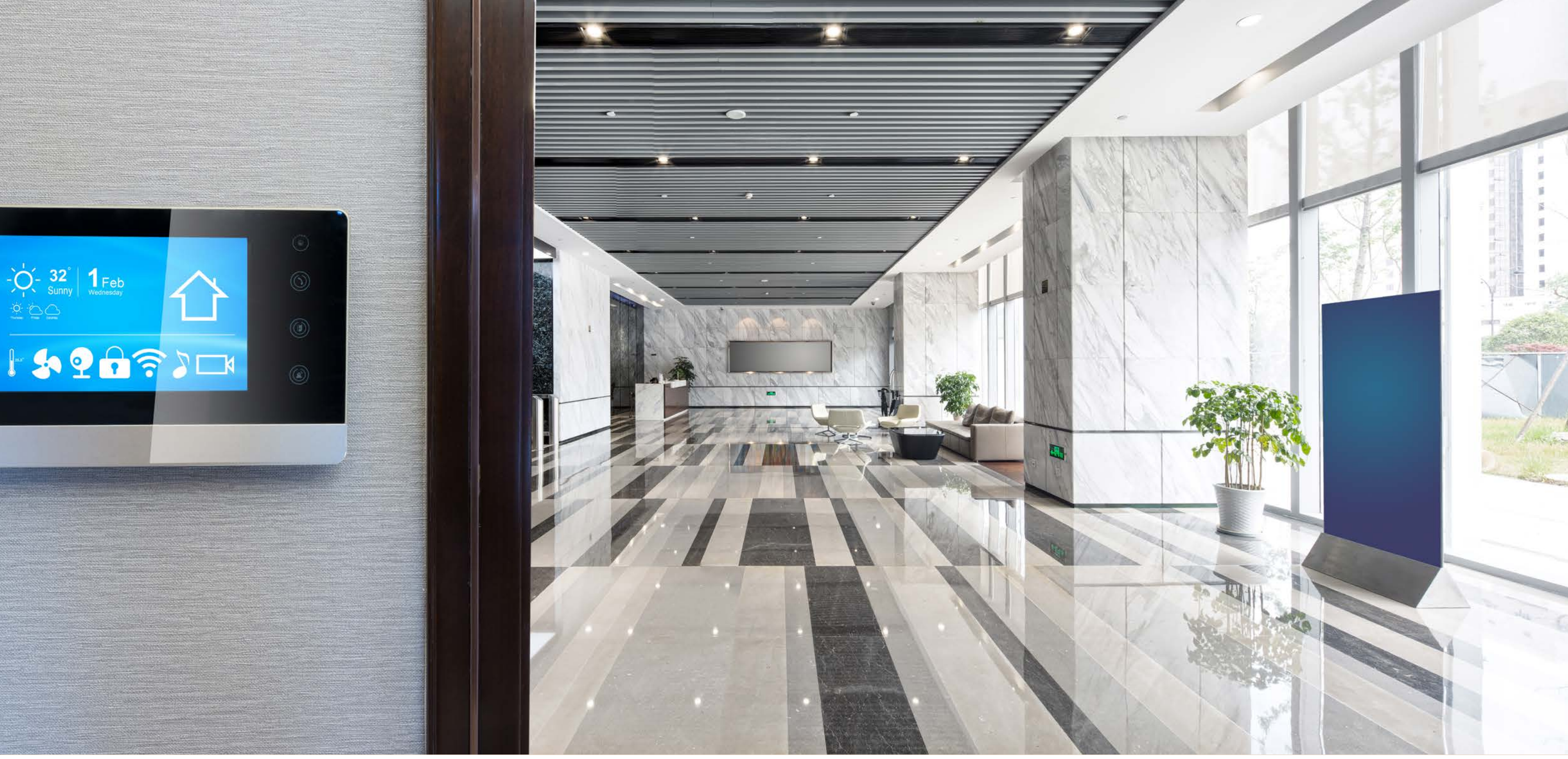

02. PROPTECH AND A RETURN TO "NORMAL"

As technology continues to advance at a breath-taking pace across all areas of life and the economy, it is perhaps no surprise that in recent years, we have seen a boom in the adoption of 'Proptech' in the Real Estate sector.

A term that has been widely adopted for a number of years, Proptech generally applies to any form of digitisation or technology that looks to simplify an existing process within the sector. Early examples include disruptors like Zoopla in the residential space, but the term Proptech casts a much wider net; encompassing anything from smart security systems through to sensor-adjusted air conditioning, and everything in-between.

Now COVID-19 appears to have accelerated the trend of Proptech adoption in both commercial and residential real estate segments. For example, the ability to understand the movement and occupancy of people within a building, for instance, has always been an attractive proposition, as it allows an occupier to better utilise its space, and re-purpose areas that are being under-utilised. With social distancing here to stay in the medium term and the safety of tenants the absolute number one priority, this technology has rapidly moved from a "nice to have" to almost a necessity as part of any significant return to the workplace.

A recent study by EQUIEM[1] in their global office tenant report found that 60% of occupiers will not return to the workplace until "it feels safe." Furthermore, it cites that the two of the most critical factors to achieving this are information and communication; two things that are arguably only truly deliverable through embracing some form of technology. It is fully understandable that tenants will now want to have certainty around cleaning regimes, and real-time updates on new in-building COVID-19 cases, in a way that was not previously required. Whilst the communication of information quickly and widely is potentially achievable through existing technology such as mobile phones, built in alarm systems and email, the ability to capture and interpret that data in real time so that it is ready to disseminate when it needs to be only feels achievable through autonomous data capture tools. Whilst retro-fitting this equipment may be expensive and challenging, it certainly appears to be the case that all future developments are now treating this as an integral part of building design and planning.

1 https://assets.website-files.com/5c86f3fc3f656c6cf4d2c540/5ef610aa778e8383226e51c5_Equiem%202020%20Global%20Office%20Tenant%20Report%20-%20COVID-19%20Edition%20260620a.pdfcom/5c86f3fc3f656c6cf4d2c540/5ef610aa778e8383226e51c5_Equiem%202020%20Global%20Office%20Tenant%20Report%20-%20COVID-19%20Edition%20260620a.pdf

What does this mean for insurance?

As with most insurances, this question is best when split into two parts:

- **Material Damage** – Technology and the equipment that drives it rarely comes cheap, so property owners and tenants need to ensure that their property sums insured are adequate to cover and fully reinstate all equipment for which they are responsible in the event of damage. Linked to this, landlords also need to carefully consider their alternative accommodation conditions in their leases following a damage event, as if these require tenants to be temporarily housed in a property of equal specification, this may be more challenging, and ultimately expensive, to fulfil. Again, a regular and thorough review of these sums insured on their property policies should be undertaken to ensure they can adequately cover such an eventuality.
- **Liability** – The second, perhaps more challenging consideration, is around liability, and who is responsible in the event the technology malfunctions. Should any part of the technology breakdown and make the building uninhabitable, or even cause injury or illness; who is responsible? Does this still sit with the provider/installer, or has it transferred to the landlord? Furthermore, as buildings become more connected, they also become more exposed to cyber-attacks from criminals either trying to steal data, or to simply wreak havoc. Should this scenario play out, how secure is the data stored by the Proptech, and is any of it sensitive in any way?

Summary

It is inevitable, and undoubtedly an overwhelmingly positive thing, that technology is integrating itself into our built environment. Yet another benefit is that all this data should drive efficiency, leading to more environmentally friendly buildings – vital progress in achieving carbon neutrality by 2050. As with all progress, however, it changes a risk profile – something that Gallagher fully understands. Our in-depth experience of the property sector and risk management gives us a privileged position when it comes to helping our clients better understand these risks, as well as how they can mitigate against them.

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03.Q&A: ADVISORY SERVICE FOR REAL ESTATE LENDERS

Real Talk speaks with Darren Ting, Executive Director and Craig Charlton, Associate Director about Gallagher's newly created Real Estate Due Diligence practice, and why now more than ever, there is a greater need for trusted insurance Due Diligence providers.

1. What is the team's past experience when it comes to Due Diligence and advising lenders?

Darren Ting: As a team, we have a combined experience of 21 years providing insurance advisory services to lenders. Whilst our experience in this field is paramount to ensure we provide the comprehensive service that we pride ourselves on, it is the teams' vast experience in placing real estate portfolios into the insurance market that makes us unique. Each member of the team has been directly involved in the placement of pan-European and UK real estate insurance programmes. This experience ensures the team are fully versed with the nuances of the market and can provide an initial assessment in respect of the insurance requirements of the loan agreement.

2. Why do you think now is a particularly relevant time to be officially launching this additional service offering?

Darren Ting: There has always been scrutiny over all aspects of the lending process, however previously the insurance stream was often serviced by the legal advisors. It is clear that the tide has changed in this respect and the importance of insurance expertise to advise on this work-stream has come to the forefront, making this a perfect time to launch our offering.

The intense hardening of the real estate market has also been a factor in launching at this time as the market has changed dramatically.

Increased pricing is one outcome from this, but the shifting approach of insurers towards their policy wordings and their acceptance of changes to the policy form is far more pertinent. This shift in the placement spectrum means that certain changes to the insurance policies can be more difficult to achieve. Now, a lender who has the insurance expertise to coach the borrowers' advisors on how to achieve their goal and who can provide pragmatic placement advice is more valuable than ever.

Furthermore, we have been providing Due Diligence services to a core group of lenders for a number of years at Gallagher, meaning we have ensured that our service protocols and standards have been formalised prior to this launch.

3. What does "Due Diligence" actually mean in this context; what do you do?

Craig Charlton: Due Diligence is an overarching term, which consists of us assisting lenders throughout the entirety of the lending process. At the core of this service is our advice and expertise, which allows us to speak candidly with lenders and provide market knowledge to allow for pragmatic approaches to the insurances in place. This includes working with the lender and their advisors, but also perhaps more importantly working with the borrower and their broker. We find that clear communication channels with the borrowers' broker allows us to explain the requirements in a language they understand, and leads to a swift conclusion of the work-stream.

In addition, we also provide formal reporting by virtue of a Red Amber Green (RAG) report which clearly states which requirements have been met by insurance, and of course a Broker Letter of Undertaking.

4. Who or what does a typical client look like, and when do they approach you?

Craig Charlton: Put simply, a typical client is a real estate lender who requires support and advice in respect of the insurances pertaining to the asset(s) being used as collateral for the loan. We have been working with lenders across the spectrum from banks with a household name to boutique lenders specifically targeting certain asset classes or deal types.

It is important that we are approached at the outset of the deal, allowing adequate time to coach the borrowers' broker and ensure that the insurance requirements are achievable in the current marketplace.

5. I have a new deal on the cards but I am comfortable with everything in place; why should I use you?

Craig Charlton: There are a number of reasons as to why our service should be implemented in this instance the most pertinent of these is to employ our expertise to review the policy with a fine tooth comb as often there can be nuances to policies which are not always picked up in a legal review. Furthermore, our market knowledge allows us to advise as to whether the policy that is deemed adequate in order to meet the requirements of a loan agreement could still have potential flaws. For example, a loan agreement will generally require both Property Owners Liability (POL) insurance and Terrorism insurance to be in place; however, both requirements rarely state a specific limit of indemnity. As a result, we have seen policies in place for POL with a limit of GBP5m for a high footfall shopping centre, where generally we would expect this limit to be at least GBP25m. Terrorism insurance especially in European territories is also a potential pit fall; many policies will have a first loss limit, essentially providing protection up to a limited amount and not for the full reinstatement value. Whilst this placement structure is not inherently defective, the limit procured is extremely important to ensure the bank is protected in the event of a claim.

It is therefore the detail and market expertise that we can offer, which helps ensure that your capital remains protected.

6. If I already have a retained broker, why could they not undertake this service?

Craig Charlton: The primary reason a borrower's retained broker would not undertake this service is a conflict of interest; their broker is required to place any additional coverage required under the policy with the insurers. They would therefore be scrutinising their own work without any impartial review being undertaken by a third party. In our view, this can therefore not be relied upon.

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04. PROACTIVE REAL ESTATE RISK MANAGEMENT

Gallagher & S2 – a distinguished collaboration

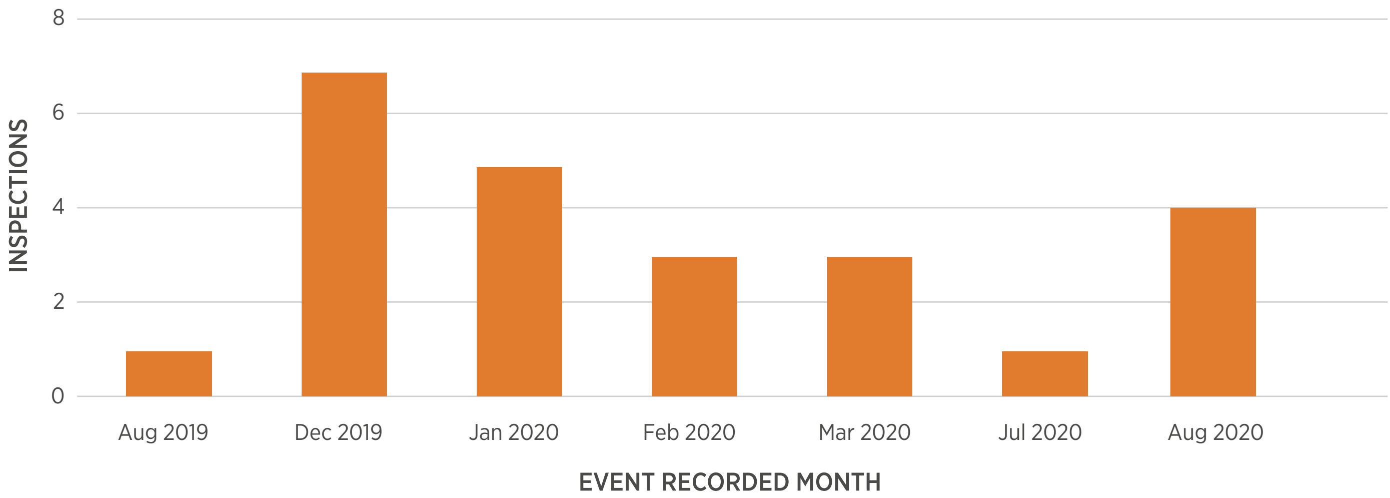
As specialist service providers in investment property risk management, we are acutely aware of the importance of asset protection and business continuity to our clients. As such, since 2016, Gallagher has worked alongside S2, a specialist safety and environmental risk management company.

Our collaboration focuses on risk management and incorporates engineering data being fed and reported into RiskWise, S2's proprietary risk management system. RiskWise is comprised of multiple modules, which can be seamlessly integrated to provide clients with visibility of their health, safety, fire and environmental risks. Using RiskWise assists with legislative compliance and provides full audit trails to demonstrate due diligence. RiskWise enables accessibility from any location and remotely, via the RiskWise App. S2 then collaborates closely with Gallagher, providing ongoing visibility of risks which could impact insurance claims.

For example, RiskWise has been utilised to support one of Gallagher's largest, pan-European Real Estate clients for a number of years. We were able to use the system to develop a robust process for effectively tracking and updating the outcomes of the client's risk improvement notices. Before they can be marked as complete on RiskWise, they must first be signed off by the insurer; this provides reassurance to the insurers that notices are being appropriately addressed.

In addition, the client, Gallagher and S2 have the benefit of full visibility of incidents that might affect the client's risk profile or insurance. Property Managers log and manage incidents that occur (such as accidents) on the system – thereby creating a 'real time' view of the client's risks. The system gives clients peace of mind that compliance issues and risks are being actively managed as well as providing them with full visibility of safety risk on their property portfolios.

Risk improvements logged by Gallagher



The importance of joined-up risk management

Historically, risk management priorities and responsibilities were separated between property investors, owners and landlords, managing agents, insurers, occupiers and insurance brokers.
By delivering a joined-up approach to risk management, there are benefits to all parties, whilst also providing a more powerful solution to asset protection and business continuity. In terms of the potential benefits, these vary across different stakeholders, but include:

Property Owners and Investors

- Asset protection against loss, damage and destruction
- Business continuity and continuity of rental income
- Rigorous health & safety management to help protect against accidents, litigation and financial penalties
- Protection and enhanced brand reputation
- Improved desirability of property, improved rental income and tenancy levels

- 24/7 online access to risk management data to help ensure effective risk management and peace of mind
- Funding often provided by the insurer for risk management
- Global consistency of risk management to defined corporate standard

Insurers

- Improved asset protection against loss, damage or destruction
- Enhanced visibility of operational and inherent risk and associated management processes
- Reassurance of risk resolution
- Reduced claims, improved claims defensibility
- Greater visibility of claims data to help identify root cause and more effectively direct risk management efforts

Managing Agents/Property Companies

- More wide-ranging and pragmatic approach
- Independent third-party reassurance for well-performing sites
- Straightforward resolution of outstanding risks due to enhanced communication between all parties

Insurance Auditing and Risk Management

In addition to implementing RiskWise, we have worked alongside S_2 to offer clients comprehensive risk and insurance audits. Whilst insurers' surveys are carried out to provide key property information for their own purposes (for example, estimated maximum loss calculations and reinsurance), they usually only cover the physical aspects of risk.

The S_2 Partnership undertakes insurance risk management audits which incorporate additional risks including liability, security, business continuity and environmental pollution, whilst also allowing for seasonal variations in property risk. The results are shared with clients as part of their risk management strategy.

Providing a more holistic approach to risk management and asset protection, an insurance risk management audit:

- Covers a wider brief of risk management, legal compliance and underwriting information
- Provides a critical review of procedures, systems, documentation and training to assess operational risk management
- Reviews legal compliance at property level to confirm risks are identified and managed (risk assessments, statutory inspections and documentation)
- Includes a detailed inspection of all areas of a property (internal and external landlord and tenant areas)
- Examines all threats which could contribute to a loss situation (e.g. fire, flood, security/theft, impact damage, escape of water, environmental pollution, subsidence, neighbours)
- Reviews all accidents and claims including attritional losses which can erode premiums
- Reports on individual properties with specific, practical recommendations and photographic evidence. Importantly, revisits and the use of the RiskWise risk management system ensure report findings and recommendations are tracked through to resolution, helping to reduce risk and ensure asset protection.

As clients become more and more sophisticated in their appetite and approach to risk, such tools and services are proving more and more popular; with the benefits being seen by all parties.

About the S_2 Partnership

Established in 1999, S_2 Partnership is an independent, privately-owned specialist safety and environmental risk management company. S_2 Partnership fully understands the importance of asset protection and business continuity for clients with property portfolios and works with them to manage and reduce risk and its consequences.

With a consultancy team comprised of specialists in their respective fields, consultants are located strategically around the UK to provide full nationwide coverage.

Widely regarded as one of the top independent specialist providers of consultancy and software, S_2 Partnership works with leading property investors, owners, managers, insurers and occupiers. We take great pride in knowing that our clients are at the core of all that we do: delivering intelligent risk management.

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05. ABORTIVE PLANNING: PLAN FOR THE UNEXPECTED

In the last few years, there have been a number of high profile cases where planning permission for large developments has failed to be approved, landing developers and their funders with a significant cost of lost planning application fees.

One example is where one of the UK's largest house builders applied for planning for 200 properties back in 2016 which was subsequently refused in 2020[2]. The refusal follows four years of re-design, planning consultant fees and architect fees – not including a loss in the value of the land of GBP1.1m. Planning was ultimately refused and it may be the case that, given the amount spent on the planning and the reduction in the land value, the developer may not appeal the planning decision.

Another development in Bradford saw its application refused for plans for 44 new homes. Planning officers recommended that the plans should be approved but a government planning inspector refused planning on the basis that it would result in an intensification of the use of a substandard access road, which is deficient in terms of width, geometry and forward visibility that would be prejudicial to highway safety. The developer decided to appeal this decision which was ultimately unsuccessful despite Bradford Council having a long-term housing supply shortage. The costs associated with this are all shouldered by developers and their lenders and this would have been a huge blow to the developer.

When looking at the viability of a site for development, a number of things are taken into consideration, but planning is one of the first and one of the largest to overcome. Fees for site investigations, planning fees and all professional service fees are non-refundable. Once you factor in legal fees, pre-app fees, market research and appeal fees , if needed, the costs can mount up.

Abortive planning insurance is a new product being offered by a limited number of insurers. This policy covers abortive planning costs in the event that a planning application is refused on appeal. This helps transfer this portion of the development risk and comforts developers with the knowledge that abortive costs can be covered.

Planning is still one of the major risks affecting developments – it is hoped that insurance can be a way to mitigate the costs of a planning system that has not been reformed in decades.

Should you wish to discuss this product and how it might be relevant to your project further, please get in touch.

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2 https://www.placenorthwest.co.uk/news/chorley-refusal-for-taylor-wimpey-after-four-years/

06. TITLE INSURANCE IN EUROPEAN PROPERTY TRANSACTIONS: GETTING THE DEAL DONE

Title insurance, covering unknown legal defects within property transactions, has been gaining traction in the last five years, with a number of high profile acquisitions using this type of insurance. Many times, the driver to purchase is a desire to cover a specific risk, such as a defect in a building permit, encroachment, restitution (particularly in CEE) and certain restrictions. It is, however, becoming more common to utilise Unknown Risk's title insurance.

Recent high profile cases in Europe highlight where, had title insurance been procured, lengthy and often costly legal battles could have been covered by a policy. A current example is the purchase of a tower in Milan by Blackstone from RCS in 2013[3]. RCS claim that the transaction should be voided as they maintain Blackstone took advantage of the asset when RCS were facing financial difficulty.

Blackstone are accusing RCS of blocking it from selling the property last year and are seeking damages. RCS have launched arbitration proceedings under Italian law to annul the sale. This has come as a shock to property investors who claim that foreign investment in Italy could suffer as a result of this case and could cause uncertainty. Regardless of the outcome of the court proceedings, Blackstone's legal fees are set to be significant.

Had an Unknown Risks Title insurance policy been procured in this case, the legal fees could have been covered and reimbursed to Blackstone. In the event that the sale is annulled by the courts, the policy is designed to pay out for loss in market value of the asset purchased.

This is just one of many cases that could have benefitted from an Unknown Risks policy. In the current economic climate, there will be new challenges faced around the disposal and acquisition of distress property assets, not only from transactions at an undervalue, but even perhaps the blocking of transactions by governments wanting to keep investment within the country – particularly if an element of bail out had been used.

Title insurance is well established in the US market with almost all property transactions requiring a policy but this is not the trend in Europe. Purchasers generally will look at the risks associated with a transaction and either price chip, accept the risk, or walk away. This is now becoming a tool for sellers to achieve the full value of the asset while providing comfort to buyers, ensuring that transactions are concluded quickly and without price chips for known title defects.

In the event that buyers are acquiring a portfolio of assets, Unknown Risks Title cover can be procured to cover unknown defects. This includes known defects for the whole portfolio – particularly in the event that there is a competitive bid situation where the speed of transaction is key as title Due Diligence (DD) is not necessarily needed on all assets, just a sample.

Not only can this type of insurance protect the property owner, it provides cover for lenders, leaseholders and successors in title, meaning that future transactions can be de-risked as well. Given the large amount of capacity in the title market, larger transactions can be covered with a single insurer providing ease and clarity in a claims scenario.

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3 https://www.reuters.com/article/blackstone-group-rcs-arbitration/blackstone-risks-paying-damages-in-dispute-with-italys-rcs-idUSL8N2D85LH

07.KEY CONSIDERATIONS WHEN ASSESSING D&O COVERAGE FOR THE REAL ESTATE SECTOR

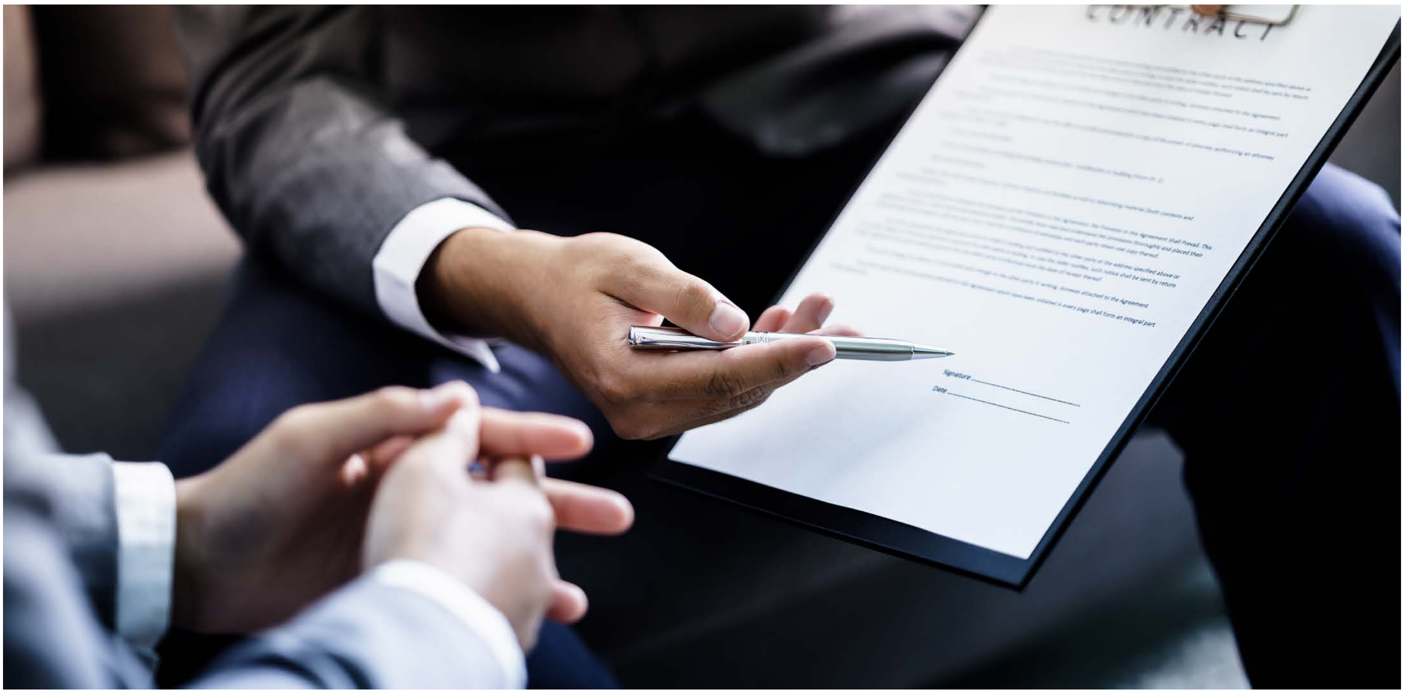
In today's highly competitive real estate landscape, reputation means everything. Your directors and officers make difficult and challenging decisions every day, and often those decisions can end up costing them personally or affecting the company's financial security.

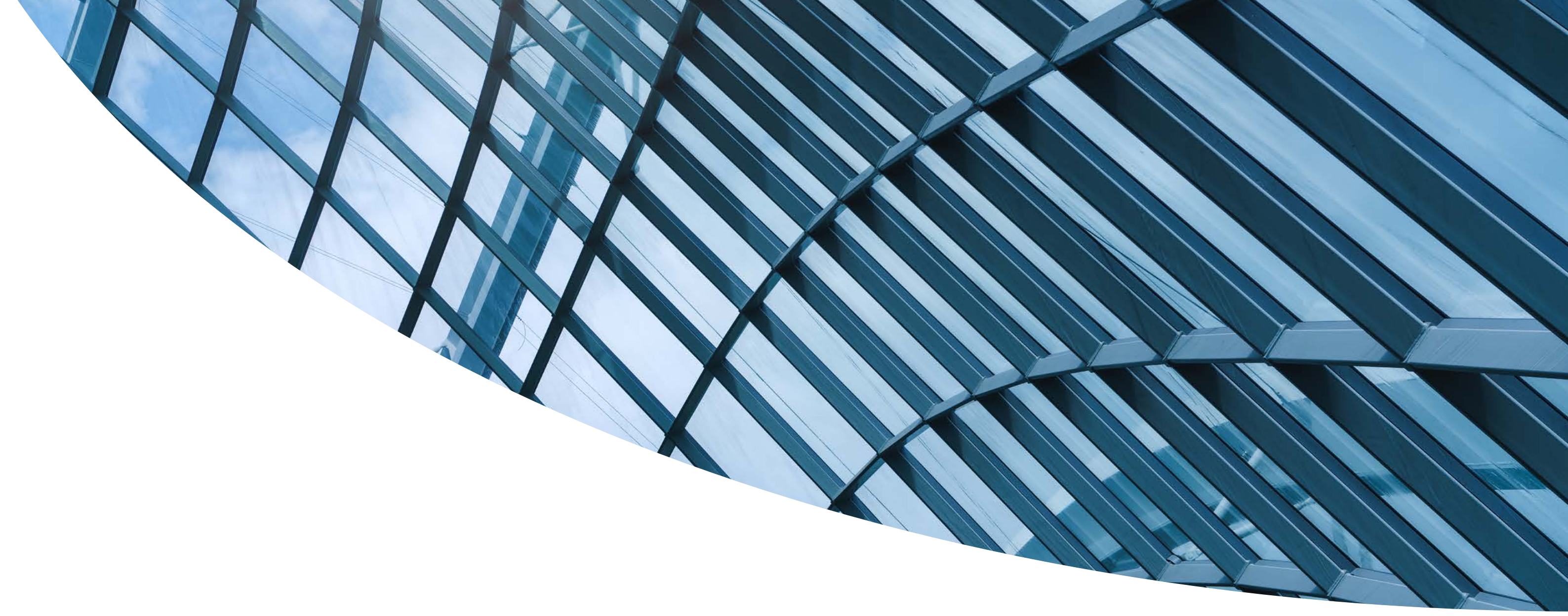
Notwithstanding the rapid spread of COVID-19 having hit the global real estate investment market in the short-term, the long-term effects are now being felt, with usual undertakings such as travel and face-to-face meetings still being restricted. Sectors such as the retail, hospitality and travel industries are amongst those who are still feeling some of the toughest effects.

For many companies in the real estate space, and the individuals that lead them, there will be significant pressure from tenants who are struggling with lockdown. Questions will be asked of businesses not allowing some form of flexibility, and balancing shareholder profit expectations with any negative press is fraught with complications. The high street was already struggling in the face of on-line competition pre-COVID-19, and wholesale job losses can trigger social outrage.

The impact is no longer restricted to those who find themselves out of work, especially as furlough schemes come to an end. Twitter and other social media platforms will force regulators to sharpen their teeth and hold businesses to account. Preparing for investigations and appearances before parliamentary commissions are costly, but can all be funded by Directors' and Officers' (D&O) insurance, not to mention the defence of allegations of wrongdoing that can follow.

It is not just employees that will suffer, from customers and suppliers to creditors and shareholders, all stakeholders face an uncertain future. Many companies in the real estate space will be fearing bankruptcy, as worldwide lockdowns have sent many countries heading into an economic downturn. Companies are naturally concerned about what it will mean for their operating results and what level of government support is forthcoming, which can all lead to claims.





As the pandemic transitions out of a public health crisis, lockdowns will slowly lift, and we will start to notice the full economic impact for the high street and beyond - how businesses continue to respond to the effects of COVID-19 is yet to be tried and tested. With no obvious quick solution available, effective communication with all stakeholders could lead to litigation.

Unsurprisingly, the real estate sector has become incredibly challenging when designing D&O insurance programmes, with exclusions being applied along with specific requests for COVID-19 underwriting information. It is important to design an insurance programme that offers the correct level of cover, one that offers balance sheet protection but also enough of the vital "Side-A" cover which will be needed should the company itself face insolvency.

The value of Side A coverage

Traditionally, D&O coverage has three insuring clauses known as Sides A, B and C.

Side A	Cover can be crucial as it focuses on protecting the people insured under the policy, not the company itself – insurers pay the Director's legal costs incurred defending a claim, offering essential protection for individuals' personal assets that would otherwise be at risk in the event of litigation.
Side B	Reimburses the company when they have stepped in to pay costs on behalf of their senior people.
Side C	Is designed to protect the company itself, from exposures such as Shareholder Class Actions (for publicly listed firms), Health & Safety Investigation Costs and Corporate Manslaughter Claims.

All D&O policies will provide Side A protection, but most commonly as part of an overall shared limit with side B & C claims, whereby all insured parties 'share' the coverage. In the current climate, it is therefore more important to consider dedicated Side A cover that can not only help act as a safeguard, but also to ensure that the limit cannot be exhausted by claims against the company itself (leaving some individual directors and officers, and their personal assets, exposed).

Gallagher can offer D&O insurance in their capacity as such, as well as for the companies themselves. D&O insurance is available for public, private and not-for-profit organisations.

We remain open for business and are fully operational, and we appreciate just how uncertain times have become for all of our clients, especially on an individual basis. If you are concerned about the level of your D&O cover, or would like to know more about protecting your personal assets – please do not hesitate to contact us.

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08. DOES THE BUYER OR THE SELLER PAY FOR WARRANTY & INDEMNITY INSURANCE

Whilst it is a commercial decision that is ultimately negotiated between the transacting parties, our clients often ask who should pay the premium and whether the costs can be 'sliced and diced'?

Depending on the fragility of the sale process, and whether an auction has led to multiple interested bidders, it is often the case that the buyer will pay for the premium in full. It is the buyer that is the insured entity, the same buyer that will be negotiating the policy and the one who will be fully involved during the claims process in the event there is a breach of warranty by the seller.

Furthermore, if there is a competitive atmosphere whereby bidders are desperately looking to differentiate themselves, the buyer may offer to pay themselves. Differentiating a bid by attaching a W&I policy means the seller can ultimately exit a transaction with no residual liability, especially if said buyer is paying the premium in full.

However, during an 'off-market' process or when an auction is not as competitive, it is often the seller that offers to pay the premium. After all, it is the seller who is ultimately benefitting from the policy as they are able to realise funds quickly and exit the transaction with no residual liability and no need for escrow.

In fact, in some instances, the seller will be pushing to pay for the premium. They may need to liquidate or wind-up and if the buyer will not accept limited warranty protection from the seller, the only way the transaction might progress is if the seller pays for the buyer to rely on the W&I insurance. A buyer may even resist the insurance and require the seller to stand behind the warranties, but in practice this position is relatively outdated.

That being said, the premium is now often split between buyer and seller - but not always equally. Since there are differing views on the level of cover required (in our experience between 15% - 30% of Enterprise Value (EV) is usually purchased), the seller is beginning to offer to pay the premium equal to a percentage of EV in the heads of terms.

Sellers often instruct a broker to source indications for a 'lighter' limit (perhaps 10%) on the assumption that, if it is not enough, the buyer will 'top up' the premium the sellers are willing to pay. This concept is becoming more common and, if added into the heads of terms, it avoids any last minute negotiations on which party pays the premium.

In summary, the premium can be allocated in a number of different ways to suit the deal structure (either balanced or imbalanced). Either way, it is good to address the question as early as possible.

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09. ENGINEERED TIMBER – WHAT, WHY, AND WHERE ARE THE INSURANCE IMPLICATIONS?

As the world of Real Estate steps up its efforts to address its environmental impact, and the enormous volume of carbon for which it is responsible, timber framed construction is proving to be an environmentally friendlier solution.

As a well-established methodology for constructing buildings, and with its embodied carbon credentials, it could well be the silver bullet that the industry is after – but it is not without its challenges. Whilst the use of timber has been sky rocketing in the housing sector for a number of years, it is yet to fully take off in the commercial and high-rise housing sectors, with the industry slower to fully embrace the engineered timber solutions available.

What do we mean by "engineered timber?"

Engineered timber is a catch-all term for structural timber products where they have been "engineered" in some way prior to installation. The most common types of engineered timber are:

- **Cross-Laminated Timber (CLT)** – Also known as X-Lam, CLT is the most commonly used engineered timber product. It is a two-way spanning, prefabricated panel which is used to form environmentally sustainable structural walls, roofs and floors. It is produced by stacking anywhere from three to seven layers of timber, each at 90 degrees to the layer below – gluing each layer to the next with a very small quantity of adhesive (circa 0.6% of the final panel). Manufacturing is done using state-of-the-art CNC (Computer Numerically Controlled) joinery machines, ensuring exceptional levels of accuracy are achieved.
- **Glulam** – Also formed by stacking sheets of timber on top of one another, but unlike CLT/X-Lam, they are stacked parallel to the grain/each other. The real advantage of Glulam is that it can form very long, continuous beams with an impressive load-bearing capacity.

Whilst there are a number of other variations of engineered timber out there, broadly speaking, they all follow one of the two models above – utilising differing numbers of layers of timber stacked on top of one another and then glued together to increase the strength, durability and fire resistance of the end product.

Why use engineered timber in a development?

There are a number of potential benefits to using engineered timber:

- **Cost** – Whilst the material cost itself can be cheaper, the overall cost of development is often significantly lower. This is because using engineered timber can speed up the overall construction programme and therefore deliver the end product much more quickly; labour onsite can also be reduced, with more of the work being done in factory ready for delivery and installation "just in time" on site.
- **Aesthetics** – Many architects are extremely keen to use engineered timber in their designs in order to create beautiful, natural and healthy looking buildings.
- **Environmental** – Perhaps the most obvious benefit; engineered timber contains embodied carbon, meaning it can hugely reduce or even nullify completely the carbon footprint of a building, long into its operational life.
- **Weight** – In locations where the overall weight and foundations of a building are an important consideration, such as over railway lines or tunnels, engineered timber is significantly lighter than its traditional counterparts, allowing for far more flexibility in building design.

What are the drawbacks?

As with anything, there are some potential concerns and hurdles to overcome when using engineered timber:

- **Fire** – With wood fundamentally being a fuel, there are concerns about the fire performance of engineered timber products. Huge amounts of research and testing are currently underway to better understand this potential risk. For the time being, concerns remain around the performance of exposed CLT and Glulam during a large fire – not so much for their ability to meet building standards for structural integrity, but more so for their long term, post-fire structural performance and remediation/reinstatement.
- **Longevity** – Whilst timber has been used as a construction material for millennia, engineering timber products are still relatively new. With buildings being designed for minimum lifespans of 50 or 60 years, no CLT or glulam structure has yet lasted the full test of time, and thus there is a concern around how the products will perform in the long term.
- **Capacity** – As architects and design engineers look to go higher and higher with timber buildings, there is uncertainty around the limitations that exist with the various products and how their performance may change under larger and larger loads.

What does all this mean when trying to insure an engineered timber building?

At present, there is still a relative lack of knowledge within the insurance sector when it comes to timber – both at broker and insurer level. There is also a lack of hard, statistical experience, meaning insurers have to base their pricing on a limited sample size, and a sample size which unfortunately in the UK does contain some large fire losses. All this makes placing timber risks, into what is already a hard market, much more challenging.

The good news , however, is Gallagher has been working with the Structural Timber Association (STA) for the last 10 years to try and educate insurers. As a result, there has been a sea-change in attitude across all sectors in recent times, with the sector increasingly keen to find workable solutions. In the past 6 months alone, two further cross-industry working groups have been set up to find solutions to building in engineered timber long-term. In the meantime, in terms of trying to insure a specific risk, our top tips are as follows:

- **Engage us VERY EARLY ON** – There is almost no point at which it would be too early to begin the conversation. If it is a building or extension/re-development in design, insurers may want to have significant input in relation to that design – whether it be mandating sprinklers, or ensuring the appropriate separation distances are being planned for. Furthermore, in what is already a hard market, engineered timber risks take even longer to place; with more insurers needing to be involved, and insurers requiring longer to understand the risk. The earlier you can begin that conversation the better.
- **Use a broker who understands timber** – Hopefully it goes without saying, but there are still pockets of expertise within the insurance sector. Engaging with the right individuals will go a long way to achieving a positive result.
- **Work with your broker when presenting information** – Insurers by nature are keen to understand the likely worst case scenario – as that is how they calculate their likely maximum loss. The more you can demonstrate firebreaks, fire protection, site management, experience and separation distances (to name but a few elements) the more favourably an insurer can look at the risk.

It would be naïve to say that insuring engineered timber right now is easy; however with the right engagement, collaboration and information, it is certainly doable – and with engineered timber being the obvious material of choice to combat climate change, new solutions are being drawn up all the time.

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10. IS MODULAR CONSTRUCTION THE FUTURE OF THE CONSTRUCTION INDUSTRY?

As various pressures such as efficiency, labour shortages and environmental impact continue to affect the construction industry, there is an ever-increasing trend moving away from traditional methods of construction and towards Modern Methods of Construction (MMC) to find solutions. Whilst MMC is used to encapsulate a great number of different methodologies, undoubtedly one at the forefront of this area is Modular Construction.

Background

Modular construction is the term generally used to describe a method of construction whereby a significant proportion of the assembly of the parts of a building is moved off-site, usually to a manufacturing-style, factory-based environment. Once assembled, these "modules" or "pods" are transported to site and connected together, usually attaching to a frame or podium that has been constructed on-site in a traditional manner.

Whilst not necessarily new to the UK, the uptake in modular construction has been significantly slower compared to areas such as Asia-Pacific, where modular construction is being adopted and pushed to its limits with increasing regularity. Investment by entities such as Goldman Sachs, who have put GBP75m into becoming the majority shareholder of modular construction specialist TopHat, has accelerated the growth and exposure in recent years in the UK, and looks set to bring it into the mainstream.

What are the benefits?

As a major contractor with significant experience in modular construction recently summarised, it should be 'faster, better, cheaper, greener and safer';

- **Faster** – Estimates vary, but it is generally considered that modular construction should lead to anywhere from a 30-50% reduction in total build time, due to efficiency gains made by the factory, the ability to build construction modules simultaneously with the groundworks and frame being constructed on-site, the ability to deliver modules as and when they are ready to be installed, and reduced weather impact than on-site.
- **Better** – This is clearly a subjective point, however the level of quality control achievable in a factory environment far outweighs what is reachable on-site. Modules can also be constructed to be more energy efficient, and detailing can be more precise when using machines to cut and shape materials to degrees of accuracy not achievable by the human hand.

- **Cheaper** – Whilst typically cost-neutral from an overall construction value perspective, the reduction in total build time generally results in cost-savings, along with the ability of a client to begin earning revenue from their completed asset more quickly.
- **Greener** – As well as being able to deliver greener buildings, modular construction usually results in a significant reduction in the levels of site traffic and deliveries, alongside a drop in fossil-fuel powered machinery on-site.
- **Safer** – With significant proportions of the build programme being undertaken in a clean, controlled, well-lit and heavily monitored environment, and with less manual labour on-site, modular construction should be significantly safer.

How about key challenges?

Like any new methodology, it is not without its challenges;

- Building design has to be finalised (and fully locked down) much earlier than with traditional methods of construction in order for it to work with the foundations and superstructure.
- The agreement of ownership, and issuance of vesting certificates, can be a significant challenge if large volumes of materials/modules are either being stored off-site, or being transported significant distances in order to reach the site. Deciding at which point ownership transfers from modular manufacturer to developer can be challenging.
- The above challenge requires financiers/funders of the development to be far more hands-on and involved in the production process in order to facilitate smooth issuance of vesting certificates and payment, otherwise efficiency gains can be quickly eradicated due to financial hold-ups.
- The ability to move between modular manufacturers on a given project is currently extremely limited due to the large variance in systems and data being used across the industry.
- Traditional forms of contract require bespoke amendments, guided by the eye of a lawyer experienced in the world of modular construction, in order to allow for elements such as testing being incorporated within the scope of works.

What does this mean for insurance?

Whilst not new to the UK construction market, insurers are still wary of modular construction, as generally they have not yet built up enough of an experience in how these buildings perform over time to have reliable actuarial models upon which to base their underwriting. As a result, there are pockets of expertise within the market, but the general attitude is one of nervousness, usually resulting in higher rates.

Key considerations to be aware of are linked to Professional Indemnity (PI) insurance;

- **The aggregation/series of claims clause** – Due to the significant potential for multiple, identical and repetitive defects in a modular design, it is vital for the manufacturer/contractor to have an appropriate clause in their PI insurance policy wording. This should allow for only one policy excess to be applied in such a scenario where each defect has arisen out of the same proximate clause, rather than each defect and claim having its own excess applied, as this could result in a huge variance in what is paid out in the event of a claim. With the rise in PI excesses in recent years, it could even be the difference between a claim breaching the excess at all, or not.
- **Fitness for purpose** – Partly a contractual issue, partly an insurance issue – employers tend to push for a fitness for purpose obligation in modular construction due to the increased reliance on the modular manufacturer for the design and performance of the building. This should be avoided wherever possible as insurers are extremely reluctant to offer protection against fitness for purpose clauses; and where unavoidable, please consult your broker as early as possible in the process to see what options you have available to you.

This is growth market, and one of the many directions in which our industry is adopting in order to achieve the aggressive government housing and emissions targets. Therefore, modular construction is likely here to stay – how far the boundaries are pushed and how quickly it is adopted, however, remains to be seen. Mark Farmer's recent appointment as the government's champion for MMC indicates the accelerator may be about to be engaged.

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11. THE LAWYERS' CORNER – PROPTECH AND SUSTAINABILITY

Over the last year or two, we have seen a rise in both the volatility and frequency of extreme weather events. Heightened activism addressing climate change has helped raise awareness around the world, including Swedish schoolgirl Greta Thunberg making headlines in 2019 after organising school strikes, which led to an international movement of students boycotting classes to participate in demonstrations demanding action against global warming and climate change.

When people think about climate change, images of heavily polluted skies above major cities or of sea turtles swimming amongst plastic bottles often come to mind. With the public now increasingly aware of the impact human activity has on the environment, more emphasis is being placed on the sustainability of the built environment.

Undeniably, the ways in which we build and engage with our offices and homes can have a huge impact on the climate and natural ecosystems. Consider, for example, the information and communications technology (ICT) industries. While cloud computing data centres do not have billowing smoke stacks, they do use tremendous amounts of energy as they keep their servers cool enough for operations. As noted in an article for Nature magazine[4], ICT companies — which include manufacturers of digital devices and televisions, as well as internet services and cloud platforms — account for more than 2% of global emissions. This carbon footprint from ICT is equal to that of the aviation industry's emissions from fuel.

Although society's appetite for newer, better technology is driving increased output, technology can also help make our built environments healthier and more eco-friendly. Here are just some of the ways in which Proptech activity can help us address our sustainability and conservation goals:

- **Facilities Management** – Facilities management is dedicated to ensuring that a building can meet the needs of the people that work within it. This covers cleaning, security, parking, as well as many other services. Proptech in this area aims to optimise workplace performance by simplifying business processes and reducing costs, with technologies often focusing on the long-term sustainability of buildings. For example, some Proptechs in this space provide drone imaging for the assessment of properties in hard-to-access locations. This may enable the spotting of areas needing repair before they need to be completely rebuilt, thus conserving resources.
- **Mapping** – Other innovations, referred to as Building Information Modelling ("BIM") technologies, can help developers utilise space more efficiently and consume less energy. Whereas traditional building design relies upon only two-dimensional technical drawings, BIM can take into consideration many more factors, including width, depth, time, costs, and environmental and sustainability analyses. BIM examples include cameras that produce 3D renderings and visualisation platforms that allow users to interact with floor plans, or tools which allow engineers to accurately simulate energy consumption.
- **IoT Home** – The Internet of Things or 'IoT' refers to the ability of a device to transfer data without requiring human interaction. IoT devices are becoming more popular in both the commercial and residential property markets, as they can provide solutions in security, automation, and energy management. From an environmental perspective, Proptech IoT devices can monitor water levels, air pollutant concentrations indoors and outdoors, and many other environmental factors. As an example, a Proptech IoT device can adjust the thermostat or air conditioning depending on the atmospheric temperature, or even the presence of occupants in a room.

The above are just some of the ways in which the property market can embrace technology to address the environmental and ecological impact of the built environment. In addition to being good for the planet, the social pressure to create "smart buildings" can provide a wealth of opportunities for entrepreneurs, technology companies, and real estate developers alike.

Of course, success for the sellers and buyers of Proptech means addressing a new set of challenges and understanding complex dynamics and considerations. DAC Beachcroft's Proptech Team brings a wide ranging service that embraces the many varied aspects of this sector and helps manage the response to change. At the heart of this is a nationwide team of real estate and technology experts that can address the risks arising in this rapidly changing environment.

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4. https://www.nature.com/articles/d41586-018-06610-y ajg.com/uk | gallagher-uk | @GallagherUK

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