TESTIMONY
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THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

Chairman Kelly, Representative Gutierrez, distinguished members of the Subcommittee, thank you for the opportunity to appear before you on behalf of the real estate industry to make the case for a federally sponsored terrorism insurance mechanism.

I am Executive Vice President of the Real Estate Board of New York. My association represents over 5,000 of the leading owners, developers, brokers, property managers, banks, pension funds, utilities, architects, attorneys, and other individuals and institutions professionally involved in New York City realty. **I should add that a considerable portion of our membership also has interests in many other regions of the United States and globally.**

The lack of terrorism insurance poses a serious risk to our nation's economy, particularly to capital-intensive enterprises, such as real estate and industrial production, whose strength decisively affects job growth and consumer confidence.

Lenders demand terrorism coverage as an absolute condition for making large-scale commitments. For example, where real estate is concerned, lenders will not give loans for new construction, purchases, or "take-outs" on recently developed high-value buildings without such coverage. The unavailability of terrorism insurance prevents them from assessing the risk and pricing the loan accordingly. As a result, investment in real estate is faltering, which cannot help the country's efforts to emerge from a recession.

Here are the problem's broader dimensions:

As of January 1st, the reinsurance industry had eliminated terrorism coverage for 70% of its customers. By July 1st, unless things change, no insurance company in the world will have back-up reinsurance for terrorism coverage.

Without terrorism reinsurance, primary insurance companies will not take the risk of providing terrorism coverage for individual large properties or those concentrated around prominent properties in urban and suburban locations. As of now, regulators in 38 states have formally agreed to allow their insurers to exclude terrorism coverage from commercial policies. While some large states, such as California, have refused to allow the exclusion, the effect of that refusal is not yet known; it may cause insurers to cut back further on the kinds of insurance they will write in those states.

When we look just at the value of the large office and multiple dwelling unit buildings in major U.S. cities and consider what it would cost to rebuild them, it becomes clear that whatever terrorism coverage is available is woefully inadequate. Lenders are requiring full replacement cost terrorism coverage for these large buildings.

To put the problem in perspective, according to the national brokerage firm Cushman & Wakefield, there are 1.1 billion square feet of central business district office space across the nation. In New York City alone, there are 400 million square feet of office space with a conservative replacement cost of $160 billion. If you add to this the estimated $127 billion replacement cost of the 727,437 multiple dwelling units, you have a total terrorism insurance demand of close to $300 billion dollars in New York City, without taking into account terrorism coverage for other types of properties (e.g., universities, hospitals, places of worship, manufacturing and warehouse properties). We are informed that the terrorism insurance problem has already affected some major religious institutions in New York City.
We understand that the insurance companies offering terrorism coverage, and there are only four of them, have an aggregate of only approximately $10 billion available. This clearly falls far short of what is needed in New York City and the nation.

As a consequence of this insurance shortage, an expanding number of property owners in urban and suburban areas, in and around airports, near railroad stations, and in major shopping and recreational locations are unable to obtain terrorism insurance on high-value parcels (those worth over $50 million). This terrorism insurance exclusion also applies to buildings of lesser value located near what are considered to be potential terrorism targets.

Here are some specific examples of how various kinds of real estate activities have been thwarted recently for want of terrorism insurance. While these examples underscore the problems faced today by some larger businesses and institutions, they are also representative of the issues faced by smaller businesses throughout the nation. To honor our pledge of confidentiality, identifying information is omitted:

Case 1.   National Office Portfolio

One of the first major real estate portfolios to go without terrorism coverage holds in excess of 25 million square feet of office and retail space in major cities across the country including Chicago, Minneapolis, Denver, Boston, and New York. The coverage came up for renewal just after 9/11. Prior to that time, the entire portfolio had blanket coverage of $1 billion. The old carrier would not renew any policies. The new carrier excluded terrorism coverage, and for the rest of the property coverage, charged a premium approximately four times that for the old full coverage policy. The only bid received for stand-alone terrorism coverage as of the end of January was from a small insurance company that quoted $25 million of coverage for a fee of $1 million. When the owners offered to take Manhattan properties out of the package to obtain terrorism coverage for the rest, they were rebuffed. Now, the owners are technically in default on their loan financing.

Case 2. Regional Office and Residential Property

The owners of a portfolio worth $3 billion, split between residential rental and office property in the Mid Atlantic and New England states, reports that they are receiving quotes for insurance that exclude terrorism coverage and are 5 times the amount they paid for full coverage in 2001. This business builds for its own portfolio and borrows against completed projects to produce capital for future buildings**. The company has 2,000 employees, many of whose jobs are at risk if the business is burdened with excessive insurance costs and risks**. Once the company's insurance expires next month, this firm will be in technical default on its mortgage agreements with over two dozen different lending institutions. A top-rated tenant has just moved into their most recently completed project under a 20-year lease. Despite the assured cash flow from this lease, as of late January, the owners could not get a mortgage on the property because available terrorism insurance coverage was capped at an amount below that required by the lender.

Case 3. Refinancing of Two New York City Office Buildings

A major investment bank agreed to refinance a $200 million mortgage on a one million square foot, top quality high-rise office building in Lower Manhattan that was not physically affected by the attack at the World Trade Center. A few days prior to the loan closing, the bank abruptly withdrew, saying its large loan committee had made a decision not to pursue such loans until terrorism insurance becomes available at a reasonable cost. As of late last week, lenders were expressing interest in the property but nothing is moving forward.

A second case came to my attention, and I have tried to understand why lenders are appearing to show interest when they will not commit to a loan under the present circumstances. The second office building is outside the borough of Manhattan, and is fully leased to a high credit tenant. The contemplated refinancing is similar in size to that for the Lower Manhattan building. While a few potential lenders are pursuing discussions, the mortgage brokers are concerned that the deal will fail once the discussion turns to insurance requirements. The mortgage brokers believe the lenders have deferred insurance discussions for now because the lenders, who want to be ready to make loans, hope that government will resolve the terrorism insurance issue before a firm commitment to lend must be made.

If these refinancings fail, not only will the owners suffer, but also the brokers will go unpaid. Moreover, mortgage brokers anticipate a drop in property values if this type of problem persists.

Case 4. Hotels

A hotel industry builder and owner firm with properties along the East Coast and in Chicago went through the insurance renewal process in early January and obtained terrorism coverage on only one $300 million property. That coverage was for $100 million and cost $3 million, 3% of the coverage. Even with that premium, the coverage included a deductible of $1 million and limited business interruption coverage to 30 days (after the owners covered the first 30 days).

The added insurance costs, including a 50% increase in workers compensation premiums, the reduction in tourism as a result of 9/11, and the inability to finance because lenders require full replacement "all risk" coverage, means that this builder will not do any new construction, and more unemployment will ensue. Since the average cost of these hotel projects is $300 million, the firm won't be able to create new jobs or add to local and state government revenues.

Case 5. Major Midtown Manhattan Office Sale

Inadequate terrorism coverage is holding up the sale of a Times Square building priced at $600 million. Shareholders, rating agencies and lenders insist on having terrorism insurance in place before the transaction can proceed. The prospective buyer's willingness to accept terrorism exposure for the uninsured portion is unacceptable to the lenders. Rates for the required insurance for the full purchase price are far beyond the buyer's means. Should the sale be cancelled, a loan in excess of $300 million will not be made, costing the originating bank fees and revenues, some of which would, inevitably, be committed to other job-generating, tax-producing business ventures.

The details of the coverage offered to date are telling. The buyers of the property have an existing blanket policy for the rest of their portfolio that was renewed before 9/11. Until then, new purchases were routinely added to the blanket policy. Now, however, this property has to be insured as a separate asset. The potential purchasers had to put down about 5% of the purchase price as a deposit knowing that if they could not prove due diligence in trying to obtain the "all risk" property coverage and the deal failed, they would lose around $30 million. A team of brokers and a consultant were put to work worldwide in an effort to patch together the required coverage.

The coverage bid so far looks like this: The insurer holding the buyer's existing blanket policy agreed to provide a first layer of terrorism coverage of $100 million for a fee in excess of $500,000, equal to 1/3 the amount they are paying for their entire blanket policy. The next insurer came in for $50 million over the first $100 million, for a fee of $500,000. These two insurers are providing $150 million of "all risk" coverage.

With a goal of $600 million in "all risk" coverage, without which the deal fails, the next two insurers bid on stand-alone terrorism insurance only. They offered to sell $150 million of terrorism insurance in excess of the first $150 million for $675,000. Another insurer bid to cover the remaining $450 million of non-terrorism coverage for $450,000. With an insurance bill at $2.125 million per year and rising, the buyer still has $300 million in terrorism insurance to go.

As of this writing, the deal is in danger of collapsing.

<u>Case 6. Potential Default of a Major Mall</u>

Just last week, a lender's representative, who had previously notified borrowers that they must maintain terrorism insurance, appears to have put one of America's largest malls West of the Mississippi in danger of default. The owners of the mall are actually numerous institutions and smaller investors in real estate funds. The owners have obtained a court order to restrain the lender from declaring the borrowers in default under the mortgage. The owners are disputing the lender representative's attempt to purchase exorbitant, but incomplete, terrorism insurance in response to the owner being unable to purchase its own reasonable and adequate coverage.

The lender's representative purchased $100 million of terrorism coverage at a cost of $750,000. This premium amount is three times greater than that for the all risk policy excluding terrorism put in place last month. In addition to the high cost, the owner would have a $5 million dollar deductible and would have no coverage if the act of terrorism were due to biological, chemical or radiation events. If the structure were to implode, as the twin towers did on 9/11, there would also be no coverage.

This example is thought to be the first of a series of test cases to be brought across the nation by this lender representative. If the courts agree that the representative does not have the right to act in this manner, it is assumed the next step will be for the representative to put the mall owner into default. Technically, any borrower required by the lender to carry terrorism coverage, and who cannot do so at reasonable cost, can be declared in default.

Case 7. University Research Laboratories

A major university's insurance coverage is up for renewal. It now appears that even if the university is able to obtain limited terrorism insurance coverage, that coverage will not extend to incidents involving the university's chemistry, biology, physics, and other laboratories. As a result, teaching and research activities at the university may have to be reconsidered, and perhaps restricted. One can only imagine the future cost to the nation in lost scientific advances if critical research and teaching activities do not occur.

Case 8. Construction of New Residential Building Stopped

As of last Friday, the developer of a proposed 30 story residential project in the Lincoln Center area of Manhattan had been unable to finance the construction due to the absence of terrorism insurance. This project would create 500 construction jobs, and cost $130 million to build. Unless the terrorism insurance can be found, this project will not go forward.

Conclusion

I'm sure that there have been, or soon will be, similar cases in **every district** represented by the members of this panel. As these examples illustrate, there is a compelling need for some federal mechanism to provide terrorism insurance, at least on a temporary basis.

For all its urgency, the lack of terrorism insurance has remained a silent crisis. Real estate owners haven't complained publicly because they don't want this situation to frighten the public or their tenants. Nor do they want it to be used by investors, lenders and potential purchasers as a justification for downgrading their asset values.

As previously noted, the reinsurance companies that provide back-up coverage have already withdrawn from 70 percent of the marketplace. Primary real estate insurance policies, written to be effective for twelve-month periods, are expiring on a staggered basis so that the full impact of the crisis is yet to be felt. **Owners whose policies will be in effect for another two or three months hope Congress will address the problem before they must obtain terrorism coverage.** Based on recent experience, these owners should have no reason to be optimistic. The first billion-dollar-plus realty portfolio lost its coverage in October. In the months since October, many more owners with multi-million dollar portfolios across the nation have told their professional associations that they have been unable to obtain terrorism coverage. Yet the Senate has not acted.

Here are the prospects for America's real estate industry and America's economy if remedial steps are not taken:

1. Sales of high-value property will be few as lenders decline to risk losing their loans and potential purchasers refuse to insure themselves for their full equity investment.

2. Sales prices will drop, reflecting increased risks.

3. Property assessments will drop dramatically. In turn, localities that depend on real property tax revenues will face harsh budgetary choices. Those governments will also sustain losses in transfer, mortgage recording and sales tax revenues because of the slowing realty market.

4. Owners in technical default on their existing mortgage agreements for failing to carry terrorism coverage will have to renegotiate these contracts, almost certainly at interest rates reflecting the lender's higher risk. Owners will also be compelled to take larger equity positions, limiting their capacity to do transactions.

5. As the cost of holding property becomes greater, owners will not have funds to make needed improvements or to invest in other properties.

6. The construction and rehabilitation work, essential to the employment of the building trades, will drastically diminish.

7. Lenders will provide less capital, declare owners in default of their mortgages if they do not have terrorism insurance, and might begin foreclosure proceedings if owners are unable to repay their loans. As a result, lending institutions' revenues will drop.

Only the federal government can provide a temporary back-up terrorism insurance coverage mechanism that will answer the economy's needs until owners and/or the insurance marketplace can price the risk and organize a solution. Such an initiative would not be a bailout for the insurance industry, it would be an effective defense to protect us, your constituents, from the economic aftershock of the September 11th terrorist attacks.

We look to Congress to do what is necessary to protect the nation's economic well-being.

The Lack of Terrorism Insurance and its impact upon Tax Revenue for New York

Prepared by Cushman& Wakefield's Financial Services Group

February 27, 2002

Introduction

Despite the ailing economy, significant capital remains available for the purchase of well located real estate assets in Manhattan. This strong demand is fueled by the historically low interest rates that are currently available for acquisition financing, and by the uncertainty surrounding alternative investments. In fact, every major Manhattan real estate offering since September 11 has been met with enthusiasm by the buying community.

Unfortunately, most of these offered transactions are not being completed due to lack of available terrorism insurance. Not only are investors reluctant to put their own capital at risk without this insurance, they are unable to reap the rewards of today's low interest rates because lending institutions are absolutely unwilling to finance an acquisition without proper insurance in place. Without financing, large transactions can not be completed (except, perhaps, by pension fund buyers who may not need financing but are bound by a fiduciary duty not to invest without proper insurance).

The irony of the situation is that the core assets that comprise New York's largest and most reliable real estate investments are the assets facing the most difficulty in terms of terrorism insurance. Thus, the most attractive acquisitions from an investment perspective are the most difficult to execute because of the perception that they are more likely targets of a future attack.

The result is that the large transactions that make up the bulk of acquisition-related tax revenues for the City and State and the Federal Government are not being completed. In addition, smaller transactions will be held up as well, adding to the tax shortfall. Unless the issue of terrorism insurance is addressed, the negative impact on tax revenues and therefore the economy will be severe.

Insurance Industry Reaction to September 11th

The catastrophic events of September 11th have caused the insurance industry to reexamine the types of coverage they provide to real estate assets. Specifically, as of January 1st, coverage for acts of terrorism were eliminated for 70% of policy holders. Even more shocking is that by July 1st of this year, no insurance company in the world will have reinsurance for terrorism coverage.

As of the end of January, regulators in 44 states have agreed to allow their regulated insurance firms to exclude acts of terrorism from their policies. Only California refused to allow this exemption.

The lack of insurance translates directly into the virtual cessation of the distribution of capital for new developments or acquisitions in major urban centers. In a time of budgetary crisis, this dearth of activity correlates directly to a reduction in tax income for both the City and State. Immediate legislative activity is necessary to reverse this fiscally devastating trend.

(Source: The Real Estate Board of New York, 2/15/02 Bulletin to Members)

Historical Transaction Volume

The following chart outlines the sales volume of major commercial office buildings in Manhattan as recorded by Cushman & Wakefield's Financial Services Group. While C&W only tracks transactions of $10 million or greater, these represent the assets most impacted by the lack of terrorism insurance. They also represent the most significant contributors to transaction-related tax revenues for the City and State. A simple average was calculate across four years to provide a basis for the likely volume for 2002.

Annual Sales Volume:	
2001	$11,561,876,295
2000	$6,695,980,671
1999	$6,155,351,939
1998	$6,011,402,000
Simple Average:	$7,606,152,726
Current Tax Rates:	
NY City Transfer Tax:	2.625%
NY State Transfer Tax:	0.400%
NY City Mortgage Tax:	1.750%
NY State Mortgage Tax:	1.000%

Potential City and State Revenue

In an effort to quantify the potential loss of tax revenue to both the City and the State, the following chart details how much revenue was received by the City and State for each of the prior four years from sales recorded in the C&W database. Since C&W cannot possibly record all the taxable activity, it is safe to assume that these figures represent the low end of the spectrum. As one can see, in a typical year the City receives over $265 million in taxes resulting from the transfer of real estate.

Legend:

CTT:	New York City Transfer Tax Revenue
STT:	New York State Transfer Tax Revenue
CMRT:	New York City Mortgage Recording Tax Revenue
SMRT:	New York State Mortgage Recording Tax Revenue

	CTT	STT	CMRT - 50% Debt*	SMRT 50% Debt*
2001	$303,499,252.74	$46,247,505.18	$101,166,417.58	$57,809,381.48
2000	$175,769,492.61	$26,783,922.68	$58,589,830.87	$33,479,903.36
1999	$161,577,988.40	$24,621,407.76	$53,859,329.47	$30,776,759.70
1998	$157,799,302.50	$24,045,608.00	$52,599,767.50	$30,057,010.00
Simple Average	$199,661,509.06	$30,424,610.91	$66,553,836.35	$38,030,763.63

* This is based on the assumption that 75% of the total value of the transactions will be financed, and that 25% of the transaction value is under a current mortgage. It is assumed that mortgage recording tax was already paid for the previously mortgaged portion and that the benefit of these paid taxes were assumed by the purchaser.

Lost Revenue on a Monthly Basis

Assuming only the following volume of deals actually close, versus the historical average, this is the potential for lost annual revenue in 2002:

	City Revenue	Lost City Revenue	State Revenue	Lost State Revenue
10% of the Average	$26,621,534.54	$239,593,810.88	$6,845,537.45	$61,609,837.08
20% of the Average	$53,243,069.08	$212,972,276.34	$13,691,074.91	$54,764,299.63
30% of the Average	$79,864,603.63	$186,350,741.79	$20,536,612.36	$47,918,762.18
40% of the Average	$106,486,138.17	$159,729,207.25	$27,382,149.81	$41,073,224.72
50% of the Average	$133,107,672.71	$133,107,672.71	$34,227,687.27	$34,227,687.27
60% of the Average	$159,729,207.25	$106,486,138.17	$41,073,224.72	$27,382,149.81
70% of the Average	$186,350,741.79	$79,864,603.63	$47,918,762.18	$20,536,612.36
80% of the Average	$212,972,276.34	$53,243,069.08	$54,764,299.63	$13,691,074.91

Potential Lost Revenue by Volume

Assuming an even dollar volume of transactions occur across 12 months,
this is the potential for lost revenue after each month that a solution to the problem is delayed:

	City Running Total	State Running Total
January	$22,184,612.12	$5,704,614.54
February	$44,369,224.24	$11,409,229.09
March	$66,553,836.35	$17,113,843.63
April	$88,738,448.47	$22,818,458.18
May	$110,923,060.59	$28,523,072.72
June	$133,107,672.71	$34,227,687.27
July	$155,292,284.83	$39,932,301.81
August	$177,476,896.95	$45,636,916.36
September	$199,661,509.06	$51,341,530.90
October	$221,846,121.18	$57,046,145.45
November	$244,030,733.30	$62,750,759.99
December	$266,215,345.42	$68,455,374.54

Case Studies

The following two transactions are examples of the plight facing the current real estate market. For each, there is a ready and willing buyer 'at the table' but unfortunately these deals reportedly cannot close for no other reason than the lack of available terrorism insurance.

450 Lexington Avenue

450 Lexington Avenue is under contract for $335,000,000*. This represents the following revenue should the deal close:

$8,767,500 in City Transfer Tax
$1,336,000 in State Transfer Tax
$4,987,500 in City Mortgage Recording Tax**
$2,850,000 in State Mortgage Recording Tax**
(*As reported in the market)
(** Based on $285 million

1515 Broadway

1515 Broadway is under contract for $496,000,000*. This represents the following revenue should the deal close:

$12,993,750 in City Transfer Tax
$1,980,000 in State Transfer Tax
$5,642,000 in City Mortgage Recording Tax**
$3,224,000 in State Mortgage Recording Tax**

(*As reported in the market)
(**Assuming 65% debt)

Conclusion

While some may argue that the notable lack of transactions for 2002 is a result of the economy, it is our opinion that this is simply not the case. There is no shortage of equity capital available, and financing rates are more favorable now than in the past. As the preceding case studies demonstrated, there are buyers waiting with capital in hand, they simply cannot execute the transaction for no other reason than the lack of terrorism insurance. The table below represents the cumulative tax revenue that is at risk of being lost in New York City in 2002 alone should this urgent issue not be addressed in a timely manner.

Average tax revenue received from the sales of commercial office buildings in Manhattan:	
Average Annual Total Revenue to NY City:	$266,215,345.42
Average Annual Total Revenue to NY State:	$68,455,374.54
Average Monthy NY City Revenue:	$22,184,612.12
Average Monthly NY State Revenue:	$5,704,614.54

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