Common Mistakes Made With Real Estate Errors and Omissions Insurance
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Complex real estate transactions gone awry can produce lengthy litigation. Even low value, frivolous situations can quickly become protracted litigation with large dollars being spent on what seems like endless defense. Real estate errors and omissions or miscellaneous professional liability insurance is a very good solution and can protect the balance sheet of the Real Estate Operating Company (REOC) and cover those defenses costs. Unfortunately, there are many pitfalls frequently created by insurance brokers who do not specialize in designing risk transfer products specifically for real estate firms.

Rarely do boiler plate insurance products line up well with a real estate company’s total risk profile. While a REOC may have both “operational” and “financial” risks on their balance sheet, most insurance companies prefer to bundle only homogenous risks into specialty policies and segment these risks into different categories (e.g., investment advice verses third party management). These separate polices frequently contain many exclusions for operations assumed to be covered by the REOC firm or a different insurance policy and are underwritten by completely separate departments or in some cases, different insurers all together. This can frequently cause uncovered losses as they fall through the cracks—if the placing insurance broker does not understand the risk profile and look out for the REOC’s best interest. If appropriate risk transfer is not well thought out in advance, it can lead to consternation at the absolute worst time. In an ideal situation, this would lead to double coverage under multiple policies. Frequently it is the opposite situation, where large coverage gaps exist in the insurance and what many assumed to be covered simply is not.
Where to start?
The best place to start is to use good risk management techniques to reduce the risk of litigation in the first place. These measures include the consistent use of industry-standard contracts and disclosure forms, and regular training for licensees on best practices for minimizing risk. Experienced counsel specializing solely in your specialty area of real estate is key.

Companies with a mature risk management and legal department can benefit from a knowledgeable broker specializing in risk transfer for real estate companies, and for smaller companies it is even more critical to have the right representation. It is always important to have experienced professionals bolstering your internal risk management function and helping you navigate the myriad of products that are required to appropriately address a real estate company’s errors and omissions (E&O) risks. It is also important that one broker handle all aspects of professional liability, since several different policies may be involved and must interact seamlessly to ensure proper coverage.

Why do I need Real Estate Errors and Omissions Insurance?
The downside of not buying insurance is simply exposing the balance sheet and ultimately the return to investors. Insurance acts as a smoothing vehicle and lends greater predictability to financial performance by minimizing the unexpected costs of periodic litigation. The amount of coverage a real estate professional requires should be determined by the nature of the firm’s operations, and whether the risk is primarily “operational” (meaning management related) or “financial” (meaning investment related). The size of the transactions and the financial complexity will be important considerations as well.

What Does Errors and Omissions Insurance Cover?
There is no such thing as a “standard” E&O policy. All are unique and therefore have different coverage grants and exclusions. In general, the policy is designed to pay for defense costs and the damages associated with wrongful acts, errors or omissions arising out of what you do for others in exchange for consideration. While most REOC’s will spend considerable time underwriting a transaction, even the most thoughtful professional can be held liable for an error, omission or mistake. Defense costs reimbursement for unfounded allegations is one of the main benefits of an E&O policy. It is not uncommon for REOC’s to spend hundreds of thousands of dollars on defense costs for a matter that ultimately gets dismissed.

A claim under an E&O policy must allege negligence in either the performance of or failure to perform professional services. Errors and omissions insurance policies have a specific limit of liability and usually include both defense cost and damage awards or settlements within the limit of liability. Keep in mind that almost all E&O policies will not cover intentional, fraudulent or illegal activities but they will defend against these allegations until they are proven in a court of law.

Lawsuits aren’t just about negligence; they are about allegations of negligence. Many innocent parties are brought into a suit simply because they were part of a transaction.
Types of Errors and Omissions Insurance for Real Estate Companies
The most common types of Errors and Omissions coverages needed for a typical REOC falls into four general categories: 1. Investment Advisory Errors and Omissions, 2. Real Estate Errors and Omissions, 3. Cyber Liability (security and privacy liability) and 4. Employed Lawyers Liability.

Investment Advisory Errors and Omissions are the exposures created when a REOC is investing money on behalf of third parties or acting as a broker/dealer—this can be through a fund or on a separate accounts basis. It may be through a general partner liability structure, where investors purchase limited partnership units, or a wide variety of other structures. The potential risk is that an investor may not be satisfied with the investing results and as a result brings suit for acts, errors, omissions, misstatements, or misleading statements. We have seen several instances when property values cycle down due to economic conditions, but investors bring suit as a means of recourse to recoup their investment. Some underwriters use the term “asset management” to refer to this exposure, while other underwriters use the same term for real estate errors and omissions, described below. This is another example of why having a knowledgeable broker is imperative.

Real Estate Errors and Omissions are exposures from any services being provided. These suits can result from a sale, lease or property management service, mortgage broker, real estate agent or broker, human resources services, administrative, marketing, strategic management support, systems support, bookkeeping, facilities support, development management, construction management, design services, etc. The exposures are as diverse as the firms themselves, and the insurance policies must be carefully manuscripted to ensure comprehensive coverage. For example, many insurers offer policies for property management, but those same insurers will exclude construction, development and mortgage broking. Other insurers will offer mortgage broking, but not human resources. Currently, there are only a few markets who will offer comprehensive coverage, but Gallagher continues to work with insurers to create new products that will cover all aspects of services provided.

Cyber Liability insurance is a common insurance term that includes many different types of potential exposures, including security and privacy liability, media liability, first party notification and credit monitoring expense. A comprehensive Cyber Liability policy will include coverage for all these exposures. Real estate companies have increased exposure due to their collection of tenant and/or investor information in addition to employee data.

Employed Lawyers insurance policies cover the exposures of individual attorneys providing legal services to their company. There may also be additional exposure to the extent the attorney is providing consultative services to tenants or other clients. These policies usually need to be amended to specifically cover the needs of the REOC depending on what services the legal department is providing.

Why the distinction from “operational risk” and “financial risk”? The main reason the distinction is made is a result of the divide in the applicable departments at the insurance company. None of the insurers who consider real estate errors and omissions use one department to underwrite “financial” exposures and “operational” exposures. The financial exposures are segregated to a group of underwriters who also review mutual funds, banks, private equity companies, broker dealers and venture capital companies, and understand the complexity of financial transactions. These underwriters review real estate investments just like any other type of investment.

Conversely, the operational aspects of real estate exposures are often underwritten by non-financial institutions or “commercial” underwriters who also review consultants, freight companies, architects and engineers, appraisers, medical billing, payroll, staffing, etc. These underwriters review real estate services provided just like those provided
by any services firm. The issue we run into with real estate is that these types of policies are generally written to be very specific, with only a few services covered and all others excluded. Real estate is particularly challenging because many underwriters do not want to insure all of the potential exposures on one commercial Errors and Omissions liability policy.

**Doesn’t My General Liability Insurance Provide the Same Protection?**

Commercial General Liability does not provide coverage for errors, contract performance disputes or any other professional liability issues. Additionally, most general liability policies need an “accident” to trigger a bodily injury or property damage. Most E&O losses arise from “financial damages” and thus would never trigger a general liability policy in the first place.

**What are some examples of types of claims?**

1. Failure to maintain the property as contracted — results in loss of property value to owner.
2. Failure to properly secure premises, e.g., lack of security on managed premises resulted in assault on tenant/visitor.
3. Commingling or mishandling of funds; e.g. failure to collect/properly account for rent monies.
4. Incorrectly processing an eviction order.
5. Risk management and/or failure to maintain proper insurance.
6. Personal injury exposures — especially wrongful eviction or discrimination.
7. Possible conflict of interest from ownership in property being managed.
About the Authors

Caley LaRue is the Co-National Director for the Real Estate & Hospitality Practice for Management and Professional Liability. He has over twenty years of experience in the insurance industry working with Fortune 100 through Fortune 1000 publicly traded companies as well as large privately held and partnerships structured organizations. He leads a national in scope brokerage team focused on Directors & Officers Liability, Fiduciary Liability, Kidnap/Ransom and Extortion, Error's & Omission's as well as Employment Practices Liability. He specializes in understanding and coaching clients on complex merger and acquisition transactions, significant claim negotiations as well as operational and construction risks related to real estate exposures.

Emily Loupee is the Co-National Director for the Real Estate & Hospitality Practice for Management and Professional Liability. She is responsible for educating the entire national and international real estate team on the management and professional liability exposures. In addition, she also educates the entire Management Liability Practice group on real estate specific concerns and issues.

For more information, contact:

Caley LaRue
Arthur J. Gallagher & Co.
caley_larue@ajg.com

Emily Loupee
Arthur J. Gallagher & Co.
emily_loupee@ajg.com