

# Understanding real estate E&O coverage

How to protect against legal exposures from each business line **Interviewed by Usha Viswanathan**

**M**ost real estate professionals understand the need for property and general liability insurance to protect their investment portfolios from perils such as fires, thefts, floods, earthquakes, construction defects or slips and falls. Few however, appreciate the importance of purchasing a comprehensive, well-structured errors and omissions (E&O) policy to cover the services they perform for others.

As the Southern California real estate market has grown and matured, firms have become much more diversified. Moreover, their businesses have developed complex organizational structures to address sophisticated tax and liability strategies, and to allow for participation by third-party investors — many of whom are large institutions. This growth has created the need for more advanced risk management and insurance coverage design, particularly in the area of errors and omissions/professional liability exposure. With the financial stakes higher than ever, the probability of a claim by a third party alleging financial damages arising out of the performance of professional services has increased dramatically. The range of risks could include negligence in anything from simple accounting errors related to the collection of rents, to significant failures to perform in construction or development management activities.

*Smart Business* spoke with Jim Lopiccoco of DLD Insurance Brokers about the importance of including an E&O policy as part of a risk management program.

## Why is E&O coverage so important for real estate service firms?

The healthy Southern California real estate market has been fruitful ground for the growth of firms with diversified service offerings. In our experience, very few firms are solely involved in property management any more. Many now offer a full range of services such as property management, asset management, construction management, development management, real estate sales and leasing, appraisal, consulting, notary, and even architectural and engineering. What this means is that fully integrated real estate firms today also are subject to a



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wide array of potential liability exposures from each of their business lines. This calls for a well-designed E&O insurance program to protect their assets, their investors, and personal assets of the individuals.

Traditional general liability insurance will only protect against claims alleging bodily injury and property damage, but will not offer protection for a claim alleging economic damages resulting from a failure to perform professional services.

## How do insurance agents assess risks that real estate services firms face?

The first course of action is for us to thoroughly understand all the various services a firm performs — whether they perform these services themselves or subcontract them to others. We do this by interviewing the client and reviewing customer contracts in detail. An understanding of the full breadth and depth of the organizational structure is also required in order to properly tailor the coverage.

Are they organized as a C Corporation or S Corporation, a Limited Liability Company, or a partnership, for example? Are they involved in joint ventures? How are their project/ownership entities structured, and

how does the ownership of these entities flow back through the rest of the organization? This process often entails a review of LLC operating agreements and partnership agreements.

## What are some of the 'hot buttons' to watch out for in these E&O policies?

There really are a whole host of coverage issues to address, but several can be easily overlooked. For example, an E&O policy typically only covers the professional services that are expressly listed on the declarations page. As such, before coverage is bound, the proposed service listing should be reviewed with the client in detail to ensure the full scope of services they provide are included.

The policy wording also needs to be carefully analyzed to make sure it will pick up all of the entities throughout the organizational structure, since each of them may be named in a lawsuit. It is not sufficient to just name the parent or main operating entity. Of course, ownership in the property managed or developed always presents a concern, since many E&O policies specifically exclude coverage for claims arising out of a property in which the insured has over a certain ownership interest.

## Are there any others you'd like to specifically mention?

Yes. Most standard E&O policies exclude coverage for any claims based upon, arising out of, or in consequence of, bodily injury or property damage. Given the fact we're dealing with real estate-related services, this exclusion can have a serious impact on the scope of coverage provided in the event of a claim. While the intent is not to make the E&O policy into a general liability policy, modifications can and should be made to this exclusion to ensure true E&O claims are not inappropriately precluded from coverage.

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