The Wild and Wooly World of Real Estate

Knowledge Knuggets, 10/16-11/16/2008

Knowledge Knuggets for 10/16 - 11/6 have been about real estate classes of business. I previously posted one regarding inspectors and have combined both these topics into one over-arching post regarding real estate exposures and market status. Happy reading:

The Wild and Woolly World of Real Estate.....

Almost every real estate-related profession has seen quite the roller coaster in the last couple of years, and the end is nowhere in sight.

Two of the higher profile classes of business -- mortgage brokers and real estate agents -- are in a state of high turmoil. We have seen consolidations and closures of businesses, and insureds dropping their coverage because they don't anticipate continuing in the field, or cannot produce sufficient business.

The flip side of the coin is on the carrier side, where many, many markets that used to write these lines of business quite readily are no longer in play. There are a few carriers that are still willing and able to write, although they are taking a conservative approach.

The real estate classes of business which you will run into, and which may be more difficult to place are:

Real estate agents and brokers
Mortgage brokers and bankers
Title agents
Escrow companies
Appraisers
Home (and other) Inspectors

In the world of real estate, agents are differentiated from brokers with regard to legal scope and services rendered. Generally speaking coverage is available only for brokers, or for firms with a licensed broker. As a practical matter, this does not pose a problem, because agents need to affiliated with a broker in order to perform services, so you will not (one would hope) ever face a situation where you need to insure an agent who is not working with a broker.

In some states, professional liability coverage is required to meet licensing standards, and in those states, there is frequently an "approved" program. The state-endorsed programs I have reviewed tend to cover only the individual agents and brokers, not the real estate agency (entity) itself. To the extent the agency holds no assets, it may not need protection, as it has "nothing to lose", but unless the owner is willing to fold the entity should a claim be made against it, declare bankruptcy, and open up another agency (all of which might create heartburn with the regulatory bodies) it's a good idea to contemplate a separate or excess policy for the entity.

Be aware that some carriers are very good at insuring pure real estate agents/brokers, but falter when mortgage broking, property management, escrow, or other related services are provided. Carriers' approach to real estate agents conducting transactions on owned properties also varies widely. Most carriers also require a minimum number of years experience (usually three to five) before a new firm will qualify for coverage.

Common causes of loss for real estate agents and brokers include failure to disclose (problems in a property or conflicts of interest such as dual agency), and discrimination. Discrimination is frequently excluded in a typical policy, but it could be picked up by third party coverage on an EPL policy, if the EPL underwriter is willing. Personal injury (libel, slander, etc.) is a good coverage to keep an eye out for, and most real estate professionals have a strong privacy liability exposure which is generally not covered by a typical E&O policy. A privacy liability policy that includes loss of paper documents would be key to address this exposure.

Next on the list is mortgage bankers and brokers.

This is such a rich and complex topic, I could spend two or three weeks, or a book, on just these opportunities and exposures. But I'll spare you for now, and perhaps put together a white paper, which I will later post on the blog. (www.professionalliabilitytidbits.blogspot.com)

First thing to know is that "mortgage banker" and "mortgage broker" are not interchangeable terms. Sometimes it doesn't seem that way, because insureds will say they're a "mortgage company", and they're not specific about what they do. Also, many carriers will say they cover "mortgage brokers/bankers" when in fact they don't provide coverage to mortgage bankers at all, or they do so on a very limited basis.

Here's the basic difference between the two:

A mortgage broker simply originates loans. They work as an intermediary between the lender (or many lenders) and the borrower. Not unlike an insurance agent.

A mortgage banker may originate loans, but most importantly, they actually fund the loans. They can do this with their own funds, or through what's called a "warehouse line of credit" where the money is supplied by investors or other lenders. After they fund enough loans, they resell them, replenish their coffers (or their credit line), and fund more loans.

Both types of entities can service loans (collect payments, manage hazard/tax escrow accounts, etc.), but that is a separate service in which they may or may not engage. More mortgage bankers do at least a little servicing, because they need to manage their loan portfolio until they can sell the loans to the secondary market. They can do the servicing themselves, or they can outsource it.

In many states, mortgage brokers must be licensed. Some states do not have a specific mortgage broking license, and the mortgage broker operates under a real estate agent's or broker's license. Licensing is one way you can tell the difference between a mortgage broker and a mortgage banker. Another way is a look at the company's balance sheet. A mortgage banker will have money somewhere. If you suspect an entity is a mortgage banker, and they don't have money on their balance sheet, the next question is "do you have a warehouse line of credit?"

Major exposures:
• Lack of disclosure of loan terms or fees
• Violations of RESPA (a real estate regulation)
• Discrimination
• Conflicts of interest
• Inappropriate underwriting or submissions

Some, but not all, of these exposures can be covered by E&O policies.

A lot of markets who were writing mortgage brokers have stopped, or are only writing retro inception now. Many who were writing mortgage bankers have stopped. Most markets are excluding subprime loans and have added other exclusions. Since many of your potential insureds have a retroactive pool of subprime activities, beware of this exclusion and try to get subprime coverage at least on the past acts, so you can avoid a gap.

Home (and Other) Inspectors:

There are several types of inspectors for whom E&O can be written. Some -- usually home inspectors -- are required to carry coverage by law in certain jurisdictions.

As a rule of thumb, most carriers want to cover those inspectors that only carry a clipboard, not a toolbox. So if an inspector also offers repair services, he or she becomes virtually uninsurable.

A quick summary of the types of inspectors:

Home Inspectors -- checking for habitability on behalf of the purchaser, generally pre-purchase
Commercial Building Inspectors -- pre-purchase inspections, or construction-completion inspections
Building Code Inspectors -- inspect for code compliance
Environmental Inspectors -- check for mold, radon, clean air, water potability, etc.

Home inspectors are the most common of these, and there are several programs for them, and some association programs. GL is frequently offered in combination with the PL. Contingent BI/PD, or lack of a BI/PD exclusion altogether, is a must for this class, as well as for all inspectors.

Some of the home inspector markets will write commercial building inspectors as well.

Code compliance inspectors are probably the most difficult class to write, but there are a few carriers who will entertain them, and a bare handful that will provide contingent BI/PD.

Environmental Inspectors are easier to write than one might think, but only if you're using the right markets. Most home inspector markets, and indeed most E&O markets, do not have an appetite for the pollution hazard and catastrophic contingent BI/PD exposure presented by environmental inspectors. Environmental markets, however, view this class favorably, and provide broad coverage and attractive pricing.

One thing to note -- the word "environmental" sometimes can refer to matters of industrial hygiene (the "environment" in which the workers perform their tasks). If the insured is involved in inspecting industrial plants and recommending modifications to ergonomics or processes, they are more along the lines of a safety consultant than a true "inspector", although the terms are somewhat interchangeable.

So after exploring real estate agents/brokers, mortgage brokers/bankers, and all manner of inspectors, your might ask "What else is there?"

It just so happens I have an answer for you.

Title agents, escrow agents, appraisers, foreclosure services, mortgage field reps, debt negotiators, property managers, leasing agents, as well as real estate investors and investments.

The first three classes mentioned above have seen an increasingly shrinking marketplace. Used to be they could be written for pennies on the dollar, and had many association programs that offered broad coverages on the cheap. However, with the downturn in the housing marketplace, and homeowners scrambling to find any way they can to hold onto their houses, there are increasing claims against these professionals.

Also, appraisers have been deemed to be in cahoots with real estate agents and mortgage brokers in supporting inflated home values that justified suspect loans, and now they are viewed with quite a bit of distrust by the carriers.

Several carriers have just outright stopped insuring these classes, and others are more closely underwriting and are increasing pricing and retentions.

Mortgage field reps are those people who will go out to a foreclosure property to make sure it's there, take a few pictures from the outside, and report back to the mortgagee. An interesting class without a huge exposure, they are frequently required by the mortgagee to carry coverage. One must be very careful to distinguish them from "home inspectors" because the risk is not at all the same, and only certain niche carriers do a good job with home inspectors, while other carriers altogether can do a good job with field reps.

Debt negotiators are all the rage. They will intervene with lenders on behalf of borrowers (or sometime at the behest of real estate agents or mortgage brokers looking to get some deals done) and facilitate the borrower and lender reaching a mutually beneficial agreement about how a loan can be structured. If the debt negotiator actually goes to the extent of proposing refinancing and/or shopping a refinance deal, they are actually a mortgage broker and must be insured as such.

Property managers and leasing agents haven't seen too much of an upset in this real estate market yet. Perhaps because rental properties are only more valuable and needed in this time where people are having to leave their homes, or where home sales have diminished. Commercial risks are not as easy to insure as residential, for the obvious reason that there is a lot more at stake in each transaction. Tenant discrimination coverage is generally provided separately from E&O. It can be written on the same policy, or in concert with the E&O, but it is a separate underwriting process, separate app or supplemental (or segment of the app).

Real estate investors and investments include all manner of private equity firms, REITs, 1031 exchanges, and any other type of person or firm that purchases, holds, manages, or sells property with investment funds for any reason other than to occupy it themselves. Most of these firms execute deals on behalf of third parties on at least one-half of the transaction (i.e. a third party buyer, or a third party owner), they may be completely arms-length facilitators with both buyer and seller being third parties, or they may be executing transactions for the benefit of investors. This private equity exposure has become more difficult to insure as the profit prospect of this line of investment has become more questionable. However, coverage is still available at a price, especially for insureds who have a track record of success and who provide proper disclosures to investors.

One interesting thing regarding real estate investment-related firms -- the D&O and E&O exposures are frequently indistinguishable and should generally be written together on one policy, or at least with one carrier. You can imagine the difficulty in trying to sort out whether the sale or management of a property gone bad is an affront to the investors as a fiduciary issue of proper caretaking of corporate assets, or whether the investors got rooked into a deal where the so-called professionals couldn't tell La Jolla from a hole in the ground and were incompetent to perform the services of evaluating, buying, managing or selling properties. Does the claim arise from the professional service rendered? Or does it arise from the breach of fiduciary duty as a D or O of the company? Much safer to insure both whenever possible.