

Reps & Warranties Insurance Creeping Into Real Estate Deals

By **Andrew McIntyre**

Law360, Los Angeles (May 04, 2015, 3:47 PM ET) -- Representations and warranties insurance is making its way into real estate transactions, particularly complex entity transfer matters, and as more deals involve real estate investment trust shares or other entities, buyers, sellers and lawyers are trying to get a handle on such real estate-related coverage — not an easy task, given the lack of a track record.

Reps and warranties insurance, a common means of limiting liability in mergers and acquisitions, has to this point been little used in real estate deals. But as real estate deals have become more complex and extended beyond simple transfers of real property, more companies are eyeing the coverage.

Several lawyers said their firms have recently had or scheduled meetings with insurance brokers to learn more about the ins and outs of reps and warranties insurance for real estate deals.

"It's creeping into asset deals," said Stephen A. Cowan of DLA Piper. "It's basically an expansion from the M&A transaction world."

Representations and warranties, crucial parts of purchase and sale agreements, are assertions from both parties about things such as financial statements.

Decisions to conduct deals rely on these statements, and in the context of mergers and acquisitions, it's not uncommon for the buyer and the seller to purchase insurance protecting them from loss should one or more of the reps and warranties prove to be false or inaccurate.

Since traditional real estate deals — selling single properties — differ from the more complex sale of a company or other entity, reps and warranties insurance has in the past seldom been used for them.

But parties in real estate deals are showing more interest in the coverage, lawyers say.

"This is becoming more common," Robert J. Ivanhoe of Greenberg Traurig LLP wrote in an email. "Not so much in a typical property sale, though I have seen that more often as well, but where there is a sale of stock of a REIT or other corporation or membership interests in [a limited liability company] where the insurance would cover certain entity-level representations or tax representations."

Many purchases of U.S. trophy assets by foreign wealth funds have been set up so a newly created REIT bought the asset or a stake in it, said Thomas J. Henry of Willkie Farr & Gallagher LLP.

Many of those assets are being sold now to realize significant profits from today's low capitalization rates, and the properties are often sold as shares of the REIT.

Deals like this often lend themselves to reps and warranties insurance.

"I've seen this on occasion," said Leonard X. Rosenberg of Mayer Brown LLP, referring to the use of reps and warranties insurance for real estate deals. "A bit more in stock deals involving real estate."

Chief among the concerns when an entity is involved are representations connected to the accuracy and truthfulness of financial statements that may go back several years.

And if there are any liens on the shares trading hands, reps and warranties outlining those liens are crucial as well, Henry said. Reps and warranties coverage is more important in the transfer of shares than in the transfer of real property, since with real property, one can run a title search and discover liens on the property, and title insurance covers many issues.

"There is a big push on the insurance side to get us up to speed and more knowledgeable," Henry said. "You're going to see more and more clients ... looking at this product and thinking about buying it," he added, referring to buyers who are acquiring real estate through entity acquisition, as opposed to real property acquisition.

One of the major issues companies are struggling with, though, is cost. While it's become common to purchase the insurance in M&A deals, the relative novelty of the coverage in real estate deals is making many buyers unwilling to pay for it.

But for increasingly complicated real estate deals and deals involving multiple assets, the coverage may start to make more sense, lawyers say. And insurance companies are looking to capitalize on this by reaching out to law firms.

"Some of the insurance companies are getting people to consider this for real estate," said Joel H. Rothstein of Paul Hastings LLP. "Where it makes sense is where you have more complicated deals that are fashioned not as an asset but as an entity. One of the arguments is that this makes sense for real estate if you have a complicated situation."

But with such insurance still in its nascent stages, it remains to be seen just how the policies will work and how smoothly and quickly the claims process might go, according to Diane E. Webster of Hinshaw & Culbertson LLP.

Yet unknown, Webster said, is: "Are these insurers reluctant to pay out, or is it easy?"

--Editing by Kat Laskowski and Patricia K. Cole.