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# E&O RISK MANAGER

HELPING REAL ESTATE PROFESSIONALS REDUCE THEIR CLAIM EXPOSURES

## AVOID MAKING GUARANTEES ABOUT THE REVENUE POTENTIAL OF PROPERTIES

*Many agents are facing low inventory and multiple offers on properties. In such scenarios, it may be tempting to offer certain guarantees about a property to make a sale. It's important to resist this urge. Learn why by reviewing this real-world example.*

### SITUATION

A real estate agent marketed a commercial property that included street-level retail with several residential units on the upper two floors. The owner of the property operated a failing video rental business and was eager to sell the entire building before the mortgage holder undertook foreclosure action. On the other hand, the residential units were producing a steady stream of revenue since they were occupied by longtime occupants who were making timely rental payments.

### PROBLEM

Optimistic about the location of the property, the real estate agent erroneously believed a retail operation could be successful. Additionally, the real estate agent assumed the residential lease amounts could be increased since the tenants were comfortable living there and were unlikely willing to move.

### MISTAKE

The real estate agent guaranteed that a prospective buyer's greeting card business would generate a positive cash flow and the tenants would be able to absorb an increase in their monthly rent.

### RESULT

Given these assurances, the buyer decided to acquire the property and notified the tenants of their respective rent increases shortly after the close of escrow. Within the first few months, four of the six tenants informed her they were unable to pay the increase and decided to move. Due to COVID related issues, the buyer

had trouble finding replacement tenants willing to pay what she needed to make the residential component successful.

Compounding the problem, the greeting card business was not seeing the desired foot traffic and corresponding revenue. Over the ensuing 18 months, the status of the business remained unchanged, so the buyer sued the real estate agent alleging that he intentionally misrepresented the property's profit potential. Damages sought included both lost business profits and lost rental income. The parties ultimately resolved the litigation for \$100,000 in lieu of enduring a two-week trial.

### PREVENTION

An agent should never make promises or guarantees about the revenue potential or future value of any property marketed for sale. Acting outside the scope of expertise is a dangerous proposition and should be left to a buyer as part of their due diligence obligation.

Always recommend in writing that buyers seek counsel of qualified accounting and financial planning experts to help them make decisions on whether to acquire revenue-producing property. Following this practice will not only result in satisfied buyers but will help avoid unwanted litigation as well.

It should be noted that most, if not all, real estate errors & omissions policies do not provide coverage for claims arising out of promises, warranties, or guarantees made as to the future income/value of property or the performance of a business. **P**



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