24 Property Management

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MANAGEMENT FUNCTIONS

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Property management is a specialty within the real estate profession. Many states require persons who manage real estate on behalf of other persons or entities to be licensed as real estate brokers. Other states license such persons specifically as property managers. Real estate firms that handle the sale of commercial and investment properties are in a natural position to manage those properties for their owners. Some property managers work for firms that manage multiple properties under blanket management contracts. Others are independent agents. Some are employees of the owner. They generally fall into one of the following categories:

- **individual property manager--** usually a real estate broker who manages properties for one for one or more owners; may belong to a small property management firm devoted to full-time property management, be self-employed, or be one of several managers in a large real estate firm.

- **individual building manager--** usually manages a single large property; may be employed by a property manager or directly by an owner; may or may not have a real estate license.

- **resident manager** (residential properties only)**--** lives on the property and may be employed by a real estate broker, a managing agent or an owner to manage a property on a part-time or full-time basis; may be required by state law for properties of certain types and sizes.

A manager has a fiduciary relationship with the principal and, in general, is charged with producing the greatest possible net return on the owner's investment while safeguarding the value of the investment for the owner/investor. At the same time, the manager has some responsibilities to tenants, who want the best value and the best space for their money. Professional managers are therefore much more than rent collectors. They need technical expertise in marketing, accounting, finance, and construction. Property managers often specialize in one type of property - apartment, office, retail, industrial, farm, single-family-and acquire specialized knowledge of that property type. Whatever the property type and management arrangement, the manager's work involves leasing, managing, marketing, and maintaining the property. The services a manager provides thus can be seen to fall into three areas: financial, physical, and administrative. Specific functions, duties, and responsibilities are determined by the management agreement, although most agreements will include at least the following functions.

Reporting

Financial reporting to the principal is a fundamental responsibility of the property manager. Reports may be required monthly, quarterly, and annually. Required reports typically include an annual operating budget (see below); monthly cash flow reports indicating income, expenses, net operating income, and net cash flow; profit and loss statements based on the cash flow reports and showing net profit; and budget comparison statements showing how actual results match the original budget.

Budgeting

An operating budget based on expected expenses and revenues is a necessity for management. The budget will determine rental rates, amounts available for capital expenditures, required reserve funds, salaries and wages of employees, amounts to be paid for property taxes and insurance premiums and mortgage or debt service. It will indicate the expected return, based on the previous year's performance. A typical budget will contain a projection, also based on past performance and on current market information, of income from all sources, such as rents and other services, and of expenses for all purposes, such as operating expenses, maintenance services, utilities, taxes, and capital expenditures. Operating statements itemizing income and expenses are then presented to the owner on a regular basis so that the owner can evaluate the manager's performance against the budget.

Income. The total of scheduled rents plus revenues from such sources as vending services, storage charges, late fees, utilities, and contracts is the ***potential gross income***. Subtracting losses caused by uncollected rents, vacancies and evictions gives ***effective gross income***. Operating expenses are subtracted from this total to show ***net operating income***. When debt service and reserves (which are not counted as operating expenses) are subtracted, the result is ***cash flow***.

Expenses. Expenses may be fixed or variable. Fixed expenses are those that remain constant and may include operating expenses, regular maintenance costs, and administration. Variable expenses are those that may change from month to month or occur sporadically, such as specific repairs or capital expenditures.

Capital expenditures. Expected expenditures for major items such as renovation or expansion should be included as a budgeting item. Large-scale projects are typically budgeted over a period of years.

Cash reserve. A cash reserve is a fund set aside from operating revenues for variable expenses, such as supplies, redecorating, and repairs. The amount of the reserve is based on experience with variable expenses in previous years.

Renting

The property manager, whose full responsibilities include maintaining and managing the property in accordance with the owner's financial goals, include seeing that the property is properly rented and tenanted. The manager may use the services of a leasing agent, whose concern is solely to rent the space. In such a situation, some of the manager's tasks may be performed by the leasing agent. Renting the property includes the following tasks, regardless of which party is actually performing them.

Controlling vacancies. There are many possible reasons for vacancies in a building:

- rent too high or too low
- ineffective marketing
- management quality
- poor tenant-retention program
- image and appearance problems
- high market vacancy rate

Successful managers look for these factors and take steps to limit or counteract their effects.

Marketing. Finding and attracting the right kind of tenants for a property is the aim of a marketing program. A marketing plan based on the property's features and the relationship between supply and demand in the market area, and consonant with the money available, will determine the best mix of advertising and promotional activities. Marketing methods include:

- billboard advertising
- brochures and fliers
- meetings and presentations
- networking
- newspaper ads
- radio and television advertising
- signs
- tenant referrals
- websites and online services

The efficiency of marketing activities can be judged in terms of how many prospects per completed lease they generate. The lower the cost per prospect per lease, the more effective and efficient the program.

Setting rents. Rental income must be sufficient to cover fixed expenses, operating expenses, and desired return on investment. But rental rates must also be realistic, taking into account what is happening in the market. The manager must consider prevailing rents in comparable properties as well as vacancy rates in the market and in the property. The manager makes a detailed survey of competitive space and makes adjustments for differences between the subject property and competing properties before setting the rental rates for the property. Residential apartment rates are stated in monthly amounts per unit, while commercial rates are usually stated as an annual or monthly amount per square foot. If vacancy rates in the managed property are too high, the manager may have to lower rates or identify problems in the property or its management that are contributing to vacancy level. On the other hand, if the property's vacancy rate is significantly lower than market rates, the manager may conclude that higher rental rates are called for.

Selecting tenants. To ensure that the property produces the desired level of income from rent, it is essential to find the most suitable tenants. For commercial space, the manager must determine that:

- the space meets the tenant's needs for size, configuration, location, and quality.
- the tenant will be able to pay for the space.
- the tenant's business is compatible with that of other tenants.
- there is room for expansion if the tenant's need for space is likely to grow.

For residential space, in addition to ascertaining the tenant's creditworthiness, the manager must be careful to comply with all federal and local fair housing laws. A manager should collect the same type of information on all prospective tenants. However, even though the law prohibits discrimination on the basis of race, sex, age and other protected classes, a manager may discriminate in certain other ways. For example, a manager has the right to refuse to rent to a person who has a history paying rent late, damaging property, fighting with other tenants, or spotty employment.

Collecting rents. The lease agreement should clearly specify the terms of rental payment. The manager must establish a system of notices and records as well as a method of collecting rents on schedule. Compliance with all state laws and regulations concerning collecting and accounting for rents is a necessity to avoid unwanted legal complications. As for monies received, the manager must follow trust fund handling procedures established by law and laid out in the rental and management agreements. If authorized by the management agreement, the manager may also collect security deposits and handle them as required by law.

Maintaining tenant relations. Happy tenants remain in a rented space longer than unhappy tenants. High tenant turnover adds to increased advertising and redecorating expenses. For these reasons, it is incumbent on the manager to

- communicate regularly with tenants
- respond promptly and satisfactorily to maintenance and service requests
- enforce rules and lease terms consistently and fairly
- comply with all relevant laws, such as fair housing and ADA (Americans with Disabilities Act) regulations

Legal issues (Fair Housing, ADA, and ECOA). Fair housing laws govern landlords and tenants just as they do sellers and buyers. They ensure that persons receive fair treatment regardless of race, color, religion, national origin, sex, handicap, or familial status. Families with children must receive equal treatment with those who do not have children. Landlords cannot charge higher rents or security deposits because of the presence of children. Managers must make sure that their marketing and leasing practices are in accordance with fair housing laws.

The Americans with Disabilities Act similarly requires landlords in certain circumstances to make housing and facilities available to disabled persons without hindrance. Familiarity with this law and with the latest state, federal, and local fair housing laws is essential.

The Equal Credit Opportunity Act, which prohibits discrimination in lending, applies to how property managers evaluate potential tenants. The manager must be consistent in evaluating the creditworthiness of applicants. The same application forms and the same credit requirements should be used with all applicants.

Property maintenance

Physical maintenance of the property is one of the property manager's primary functions. The costs of services provided must always be balanced with financial objectives and the need to satisfy tenant needs. The manager will also be concerned with staffing and scheduling requirements, in accordance with maintenance objectives.

Maintenance objectives. The foremost maintenance objective is generally to preserve the value of the physical asset for the owner over the long term. Although not every property is best served by vast expenditures on top-level maintenance, it is almost always important to maintain the viability of the property as a rental. Three general types of maintenance are required to keep a property in serviceable condition: routine, preventive, and corrective.

Routine maintenance. Routine maintenance activities are those necessary for the day-to-day functioning of the property. Regular performance of these activities helps to keep tenants satisfied as well as forestall serious problems requiring repair or correction. Routine activities are such things as:

- regular inspections
- scheduled upkeep of mechanical systems-heating, air-conditioning, rest rooms, lighting, landscaping
- regular cleaning of common areas
- minor repairs
- supervision of purchasing

Preventive maintenance. Preventive maintenance goes beyond the routine in attempting to deal with situations that can become serious problems if ignored. Seasonal or scheduled replacement of appliances and equipment, regular painting of exterior and interior areas, and planned replacement of a roof are a few examples.

Corrective maintenance. When routine and preventive maintenance fail, repairs and replacements become mandatory to keep the property operational. A boiler may develop a leak, an air-conditioning unit may break down, an elevator may cease to function properly.

Maintenance contracting. Depending on building type and size, tenant needs, and budgetary constraints, a manager may decide to hire an outside firm to handle maintenance services rather than hiring on-site employees. Efficiency, competence, responsiveness, and effective cost will be major deciding factors.

Construction

Commercial and industrial property managers are regularly called upon to make alterations to existing space to accommodate a tenant's needs. They may also have to undertake or oversee construction that alters or expands common areas or the entire building itself. Again, such work may be contracted out or done by in-house employees.

Tenant improvements. Alterations made specifically for certain tenants are called build-outs or tenant improvements. The work may involve merely painting and re-carpeting a rental space, or erecting new walls and installing special electrical or other systems. In new buildings, spaces are often left incomplete so that they can be finished to an individual tenant's specifications. In such cases, it is important to clarify which improvements will be considered tenant property (trade fixtures) and which will belong to the building.

Renovations. When buildings lose functionality (become functionally obsolescent), they generally also lose tenants, drop in class, and suffer declining rental rates. Maintenance becomes more expensive because of the difficulties of servicing out-of-date building components. Renovation may solve some of these problems, but the manager will have to help the owner determine whether the costs of renovation can be recovered by increased revenues resulting from the renovation.

Environmental concerns. A variety of environmental concerns confronts a property manager, ranging from air quality to waste disposal, tenant concerns, and federal, state and local environmental regulations. The managed property may contain asbestos, radon, mold, lead, and other problematic substances. Tenants may produce hazardous waste. The manager must be aware of the issues and see that proper procedures are in place to deal with them, including providing means for proper disposal of hazardous materials, arranging for environmental audits and undertaking possible remediation. For instance, an audit may show that a building is causing tenants to become sick because of off-gassing from construction materials combined with a lack of ventilation. Remediation may consist of nothing more than replacing carpets and improving ventilation, and the manager, if empowered to do so, should take the necessary steps.

Legal concerns (ADA). The Americans with Disabilities Act requires managers to ensure that disabled employees and members of the public have the same level of access to facilities as is provided for those who are not disabled. Employers with at least fifteen employees must follow nondiscriminatory employment and hiring practices. Reasonable accommodations must be made to enable disabled employees to perform essential functions of their jobs. Modifications to the physical components of the building may be necessary to provide the required access to tenants and their customers, such as widening doorways, changing door hardware, changing how doors open, installing ramps, lowering wall-mounted telephones and keypads, supplying Braille signage, and providing auditory signals. Existing barriers must be removed when the removal is "readily achievable," that is, when cost is not prohibitive. New construction and remodeling must meet a higher standard, Managers must be aware of the laws and determine whether their buildings meet requirements. If not, the manager must determine whether restructuring or retrofitting or some other kind of accommodation is most practical.

Risk management

Many things can go wrong in a rented property, from natural disaster to personal injury to terrorism to malfeasance by employees. Huge monetary losses for the owner, in the form of civil and criminal penalties, legal costs, fines, damages, and costs of remediation can be the result. A manager must consider the possibility of such events and have a plan for dealing with them.

Risk management strategies. Depending on the nature of the risk, the size of the potential losses, the likelihood of its happening, and the costs of doing something about it, a manager and owner will generally choose one or more of the following risk management strategies:

- avoidance-removing the source of the risk, such as by closing off a dangerous area of the building
- reduction-taking action to forestall the event before it happens, such as by installing fire alarms, sprinklers, and security systems
- transference-shifting the risk to someone else by buying an insurance policy
- retention-taking the chance that the event is not likely enough to occur to justify the expense of one of the other strategies; self-insurance

Security and safety. A court may hold a manager and owner responsible for the physical safety of employees, tenants, and customers in leased premises. In addition to standard life safety and security systems such as sprinklers, fire doors, smoke alarms, fire escapes, and door locks, a manager may have to provide electronic and human monitoring systems (security cameras, security guards) and be prepared to take action against tenants who allow, conduct or contribute to dangerous criminal activities such as assault and drug use.

Insurance. Many types of insurance are available to allow for the shifting of liability away from the owner. An insurance audit by a competent insurance agent will indicate what kind of and how much coverage is advisable. Common types of insurance coverage for income and commercial properties include:

- casualty-coverage for specific risks, such as theft, vandalism, burglary, illness and accident, machinery damage

- liability-coverage for risks incurred by the owner when the public enters the building; medical expenses resulting from owner negligence or other causes

- workers' compensation-hospital and medical coverage for employees injured in the course of employment, mandated by state laws

- fire and hazard-coverage for damage to the property by fire, wind, hail, smoke, civil disturbance, and other causes

- flood-coverage for damages caused by heavy rains, snow, drainage failures, and failed public infrastructures such as dams and levies; flood insurance is not included in regular hazard policies

- contents and personal property-coverage for building contents and personal property when they are not actually on the building premises

- consequential loss, use, and occupancy-coverage for the business losses resulting from a disaster, such as loss of rent and other revenue, when the property cannot be used for business

- surety bond-coverage against losses resulting from criminal or negligent acts of an employee

The owner may opt for a multi-peril policy which combines standard types of commercial policies and may allow special coverage for floods, earthquakes, and terrorism.

The amount of coverage provided by certain types of policies may be based on whether the property is insured at depreciated value or current replacement value. Depreciated value is its original value minus the loss in value over time. Current replacement value, which is more expensive, is the amount it would cost to rebuild or replace the property at current rates.

Commercial policies include coinsurance clauses requiring the insured to bear a portion of the loss. Fire and hazard policies usually require the coverage to be in an amount equal to at least 80 percent of the replacement value.

Owner's policies do not cover what is owned by the tenant. Tenants should obtain their own renter's or tenant's insurance to cover personal belongings. Residential and commercial or business variants are available. The question of who owns tenant improvements is not only important when it is time for the tenant to leave the premises. It is also likely to determine whether the tenant's or the landlord's insurance company will be paying if the improvements are damaged or destroyed.

Handling of trust funds. Managers are responsible for proper handling of monies belonging to other parties that come into the manager's hands in the course of doing business. For property managers, such funds include rents collected from tenants, security deposits, and capital contributions from the property owner. State laws, usually incorporated into real estate commission rules and the state's real estate law, specify how a property manager is to manage trust funds. In general, the agent is to maintain a separate bank account for these funds, with special accounting, in a qualified depository institution. The rules for how long an agent may hold trust funds before depositing them, and how the funds are to be disbursed, are spelled out. The fundamental requirements are that the owners of all funds must be identified, and there must be no commingling or conversion of client funds and agent funds. Mishandling carries heavy penalties.

THE MANAGEMENT AGREEMENT

Components
Rights, Duties, and Liabilities

Components

The management agreement establishes an agency agreement between manager and owner as well as specifying such essentials as the manager's scope of authority, responsibilities, objectives, compensation, and the term of the agreement. Property managers are usually considered to be general agents empowered to perform some or all of the ongoing tasks and duties of operating the property, including the authority to enter into contracts. The agency relationship creates the fiduciary duties of obedience, care, loyalty, accounting, and disclosure. The contractual relationship ensures that the manager will strive to realize the highest return for the owner consistent with the owner's objectives and instructions. The agreement should be in writing and include at least the basics of any real estate contract, as follows.

- **Names of the parties**--owner, landlord, manager, tenant or other party to be bound by the contract
- **Property description**--street address, unit number and location, square footage, and other information that specifies the leased premises
- **Term**--time period (**months**, years) covered by the contract; termination conditions and provisions
- **Owner's purpose--maximize** net income, maximize asset value, maximize return, minimize expenditure, maintain property quality, etc.; long-term goals for the property
- **Owner's responsibilities--management** fees, plus any management expenses such as payroll, advertising and insurance that the manager will not be expected to pay
- **Manager's authority**--the **scope** of powers being conveyed to the manager: hiring and staffing, setting rents, contracting with vendors, ordering repairs, limits on expenditures without seeking owner permission

- **Manager's responsibilities--specification** of duties, such as marketing, leasing, maintenance, budgeting, reporting, collecting and handling rents; the manager should be included as an additional insured on the liability policy for the property

- **Budget--**amounts, or percentages of revenues, allotted for operations, taxes, insurance, capital expenditures, etc.

- **Allocation of costs--**who is to pay certain expenses, that is, which will be treated as expenses of the manager vs. which will be paid directly by the owner

- **Reporting--**how often and what kind of reports are to be made

- **Compensation--**the management fee or other means of compensation to the manager; there may be a flat fee based on square footage, a rental commission based on a percentage of annual rent, a combination of these, or some other arrangement; in compliance with anti-trust laws, management fees are not standardized but must be negotiated by agent and principal

- **Equal opportunity statement--**the HUD statement or equivalent concerning availability to all persons and classes protected by law, incorporated into the agreement in the case of a residential property

Rights, duties, liabilities

Both the manager and the landlord have rights, duties and liabilities under the terms of the management contract. How these are apportioned should be clearly stated in the agreement.

Landlord. The landlord has the right to receive rent according to the agreement, and to receive the premises in the specified condition at the end of the agreement term. The landlord and his or her agents may have the right to enter and inspect the premises, examine the books, hire and fire staff, and choose vendors. The landlord may retain or grant the power to enter into contracts, to set rents, and to select tenants. The landlord will have the right to terminate the management contract according to the terms of the contract. The landlord will have the duty to pay the agreed management fee, and to make other such payments as detailed in the agreement. State law will determine to what extent a principal is liable for the acts of the manager and the manager's employees. As owner, the landlord is liable for failures to comply with certain local, state, and federal laws, particularly the Environmental Protection Act and fair housing laws.

Manager. Depending on the degree of authority granted by the agreement, the manager may have the right to hire and fire, enter into contracts, and perform routine management tasks without interference from the owner. The manager has the duties described earlier: to maintain financial records and make reports; to budget; to find, retain, and collect from tenants; to maintain and secure the property; to meet the owner's objectives. The manager's liabilities include the consequences of mishandling trust funds, violating fiduciary responsibilities, and violating fair housing laws, credit laws, and employment laws.

Exhibit 24.1 Abbreviated Sample Management Agreement

MANAGEMENT AGREEMENT

Agreement made *[date],* between _________ , a corporation organized under the laws of the State of _______ , having its principal office at *[address],* *[city]*, *[state],* here referred to as owner, and ________ , a corporation organized under the laws of the State of _________, having its principal office at *[address],* *[city]*, *[state],* here referred to as agent.

RECITALS

1. Owner holds title to the following-described real property: *[insert legal or other appropriate description],* here referred to as the property.
2. Agent is experienced in the business of operating and managing real estate similar to the above-described property.
3. Owner desires to engage the services of agent to manage and operate the property, and agent desires to provide
4. such services on the following terms and conditions.

In consideration of the mutual covenants contained herein, the parties agree:

EMPLOYMENT OF AGENT. Agent shall act as the exclusive agent of owner to manage, operate, and maintain the property.

BEST EFFORTS OF AGENT. On assuming the management and operation of the property, agent shall thoroughly inspect the property and submit a written report to owner concerning the present efficiency under which the property is being managed and operated, and recommended changes, if necessary.

LEASING OF PROPERTY. Agent shall make reasonable efforts to lease available space of the property, and shall be responsible for all negotiations with prospective tenants. Agent shall also have the right to execute and enter into, on behalf of owner, month-to-month tenancies of units of the property.

ADVERTISING AND PROMOTION. Agent shall advertise vacancies by all reasonable and proper means; provided, agent shall not incur expenses for advertising in excess of _________Dollars ($_____) during any calendar quarter without the prior written consent of owner.

MAINTENANCE, REPAIRS, AND OPERATIONS. Agent shall use its best efforts to insure that the property is maintained in an attractive condition and in a good state of repair. Expenditures for repairs, alterations, decorations or furnishings
in excess of_________ Dollars ($ ____) shall not be made without prior written consent of owner.

EMPLOYEES. Agent shall employ, discharge, and supervise all on-site employees or contractors required for the efficient operation and maintenance of the property. All on-site personnel, except independent contractors and employees of independent contractors, shall be the employees of agent.

INSURANCE. Agent shall obtain the following insurance at the expense of owner, and such insurance shall be maintained in force during the full term of this agreement:

1. Comprehensive public liability property insurance of ______ Dollars ($ ____________) single limit for bodily injury, death, and property damage;

2. Comprehensive automobile insurance of__________ Dollars ($______) single limit for bodily injury, death, and property damage;

3. Fire and extended coverage hazard insurance in an amount equal to the full replacement cost of the structure and other improvements situated on the property; and

4. A fidelity bond in the amount of_____________ Dollars($) on each employee who handles cash, and workers' compensation and employer liability insurance to cover the agents and employees of both employer and agent.

Exhibit 24.1 Abbreviated Sample Management Agreement, continued

COLLECTION OF INCOME. Agent shall use its best efforts to collect promptly all rents and other income issuing from the property when such amounts become due. It is understood that agent does not guarantee the collection of rents.

BANK ACCOUNTS. Agent shall deposit (either directly or in a depositary bank for transmittal) all revenues from the property into the general property management trust fund of agent, here referred to as the trust account. From the revenues deposited in the trust account, agent shall pay all items with respect to the property for which payment is provided in this agreement, including the compensation of agent and deposits to the reserve accounts as provided for. Agent shall remit any balance of monthly revenues to owner concurrently with the delivery of the monthly report.

RESERVE ACCOUNT. Agent shall establish a reserve account for the following items: taxes, assessments, debt service, insurance premiums, repairs (other than normal maintenance), replacement of personal property, and refundable deposits.

RECORDS AND REPORTS. Agent shall furnish owner, no later than the end of the next succeeding month, a detailed statement of all revenues and expenditures for each preceding month. Within __________ days after the end of each calendar year, agent shall prepare and deliver to owner a detailed statement of revenues received and expenditures incurred and paid during the calendar year that result from operations of the property.

COMPENSATION OF AGENT. Agent shall receive a management fee equal to _________ percent (____ %) of the gross receipts collected from the operation of the property. Any management fee due agent hereunder shall be paid to agent within _________ days after the end of each month.

TERMINATION AND RENEWAL. This agreement shall be for a term commencing on *[date]*, and ending on *[date]*.

MODIFICATION. This agreement may not be modified unless such modification is in writing and signed by both parties to this agreement.

IN WITNESS WHEREOF, the parties have executed this agreement at *[designate place of execution]* the day and year first above written.

____

____

LEASING CONSIDERATIONS

Lease types
Owned and leased inclusions
Reversionary rights of owners
Landlord rights and responsibilities
Tenant rights and responsibilities
Evictions
Tenant improvements
Termination of a lease
Security deposit procedures
Universal Residential Landlord-Tenant Act

Lease types

Recall from the chapter on leases that a leasehold estate may grant tenancy for years, from period-to-period, at will, and at sufferance.

For years. An estate for years may be for any definite period—years, months, weeks, days. When the estate expires, the lessee must return the premises to the lessor and vacate the premises. Most commercial leases grant this type of estate.

Periodic. An estate from period-to-period does not have any definite period. Such an estate begins as a lease for a definite period but continues after the expiration of the lease, as long as the lessee continues to pay rent at the regular interval, the lessor accepts it, and no one gives notice to terminate the lease. This type of leasehold is common with residential properties.

At will. A tenancy at will is similar to the periodic tenancy, except that it does not begin with a definite period. It continues, with the consent of the lessor, as long as the tenant pays rent at regular intervals. It is terminated by the death of either party. The tenancy at will is rarely, if ever, used in a written lease.

At sufferance. A tenancy or estate at sufferance comes into existence when a tenant stays beyond the expiration of another type of lease without the lessor's permission. This type of tenancy is never intentionally used in a written lease.

Leases, depending on how rent is determined, are also defined as gross, net, percentage leases, and graduated leases.

Gross. In a gross lease, the tenant pays an established, fixed rent, and the landlord pays all property operating expenses, such as taxes, insurance, utilities, and other services. This is the arrangement commonly used in residential leases.

Net. Net leases have the tenant paying rent plus some or all of the operating expenses attributable to the rented space. This arrangement is commonly used in office and industrial leases.

Percentage. A percentage lease may be gross or net, but the rent is not fixed, but depends on the income generated by the tenant in the leased property. A common arrangement is to set a fixed base rent plus a percentage of the tenant's gross income or sales at the site. The percentage calculation may take effect only when the income reaches a certain level. This arrangement is commonly used in retail leases.

Graduated. Either a gross or a net lease may also be a graduated lease, in which the rental rate increases at specified times over the lease term.

Owned and leased inclusions

The lease should set forth items that are excluded or included in the leased property. For instance, a residential lease may include built-in appliances such as dishwashers but exclude freestanding ones, such as refrigerators. Furniture may be included or excluded. At issue for the landlord is the cost of maintenance. If a refrigerator is not included, it does not have to be maintained by the property manager.

Ownership also relates to insurance policies: one can only insure what one owns, so if a property item is destroyed by fire, the owner's policy will not provide any coverage for an item that is not included in the lease as belonging to the property. This may be of critical importance in a commercial lease where certain improvements might be owned by either the landlord or the tenant, according to the lease.

The lease should also have clear rules about making alterations. If the tenant is not satisfied with an item that is part of the property, the lease may provide for the tenant to make changes only with permission or with the obligation to return the premises to their original condition on termination, or that any alterations made to fixtures become the property of the landlord. Trade fixtures, by definition, belong to the tenant and can be removed when the tenant leaves.

Inclusions may also be of a financial nature-what is included in the rent. Principal and interest on a mortgage loan, homeowner's association dues, common area maintenance charges, liability and hazard insurance, and various operating expenses are items that might be included in the lease as the owner's or the tenant's responsibilities.

Reversionary rights of owners

Like the grantor of a life estate, the grantor of a leasehold estate retains a future interest in the estate. The lease grants a number of rights to the property, including, primarily, the rights to enter, possess, and use the property for the term of the lease. The lessee does not enjoy the full bundle of rights to the property. For instance, the lessee may not encumber or sell the property. When the lease expires (a condition subsequent), all rights revert to the original owner. A common example is the leasing of an apartment for a one-year period. When the lease expires, the lessee has no further rights in the property and full ownership reverts to the lessor. Another condition subsequent that may cause reversion of rights is tenant default.

Landlord rights and responsibilities

State law, often incorporating or modeling the Universal Residential Landlord Tenant Act (see below) prescribes rights and responsibilities for residential landlords and tenants.

Rights. Commonly, the landlord retains a right of entry into the premises in order to perform needed repairs and maintenance on a property. The lease and/or the law may specify that a landlord may enter the tenant's property only under one or more of the following conditions:

- An emergency requires the landlord to enter.
- The tenant gives consent to enter.
- The landlord enters during normal business hours and only after giving notice to either make repairs or to show the property to prospective tenants, purchasers or contractors.
- The tenant has abandoned or surrendered the property.
- The landlord has a court order allowing the entry.

Likewise, the landlord has the right to expect prompt payment of rent and adherence to building rules. At the end of the lease term, the landlord has the right to retake possession of the premises. In case of tenant breach or default, the landlord has the right to pursue the remedies provided by law, such as eviction, to take possession.

Responsibilities. The landlord (by way of the property manager), is expected to deliver a property that is habitable. This means that the landlord at the very least must:

- keep the heating, cooling, electrical, and plumbing systems in good working condition
- keep floors, stairways and railings safe and in good repair
- provide pest control as needed
- repair roof leaks and broken windows promptly.

Tenant rights and responsibilities

Rights. Beyond the right to quiet enjoyment (privacy) of a property received and maintained in a habitable condition, the tenant has other rights, depending on state law. For instance, a tenant may be able to take any of the following actions if a landlord fails to correct a problem that is the landlord's responsibility:

- move out without liability for back rent or the unexpired portion of the lease
- refer the problem to mediation, arbitration or small claims court
- after giving the owner written notification of an emergency situation, call a professional repair person and deduct the cost from the next month's rent.

Responsibilities. Depending on state law, a tenant generally must:

- Pay rent on time
- Follow the rules and regulations set out by the landlord
- Give a 30-day notice when terminating a month-to-month lease
- Return all door and mailbox keys when leaving the property

- Leave the unit in as clean a condition as it was at the start of the lease
- Keep the unit clean and sanitary
- Dispose of all rubbish, garbage and other waste in a sanitary manner
- Use and operate all electrical, gas and plumbing fixtures properly
- Refrain from destroying or damaging the property
- Prevent others from destroying or damaging the property
- Use the property and the rooms only for their intended purposes

Evictions

An ***actual eviction*** follows a procedure prescribed in state law and stated in the lease contract. The landlord must serve notice on the tenant a specified number of days before beginning the eviction suit. A court issues a judgment for possession, which requires the tenant to vacate. A court officer, such as a sheriff, may forcibly remove the tenant and possessions if the tenant refuses to vacate. The landlord can then enter and take possession.

A ***constructive eviction*** occurs when a tenant vacates the leased premises and declares the lease void, claiming that the landlord's actions have made the premises unfit for the purpose described in the lease. The tenant must prove that it was the landlord's actions that were responsible and may be able to recover damages.

Tenant improvements

As discussed earlier, leased spaces are often modified to a tenant's specifications. Such alternations may be made by the landlord on the tenant's behalf or by the tenant. Buildings usually have "standard" improvements, which any tenant improvements must equal or improve on. Many leases have a clause that requires the tenant to return the premises to the condition in which they were received at the end of the lease term. Who pays for improvements and who owns them are major matters for negotiation.

Termination of a lease

Like contracts in general, leases may terminate in a number of ways. Principal among these are the following. See the chapters on leases and contract law for more information.

Expiration. A lease with a term (estate for years) automatically expires at the end of the term.

Performance. Any contract terminates when all parties have performed their obligations.

Agreement. The parties may agree to terminate the lease before the end of the term.

Abandonment. The landlord may retake possession and pursue the tenant for default if the tenant abandons the premises and fails to fulfill lease obligations. The tenant's obligation to pay rent continues.

Default or Breach. A default occurs when either the tenant or landlord violates any of the terms or covenants of the lease. The damaged party may sue for damages, specific performance (of the breached obligation), or cancellation of the lease. When the default arises from the tenant's failure to pay rent or maintain the premises, the landlord may sue for possession and for eviction. Before filing suit, the landlord must give proper notice and allow the tenant to remedy the breach. The most common form of landlord default is failure to maintain the property and provide services. The tenant may vacate the premises and declare the lease cancelled if the landlord's default has made the premises unoccupiable. This action is called constructive eviction.

Notice. A periodic leasehold or tenancy at will may be terminated by proper notice given by either party.

Destruction. Property destruction is grounds for termination of the lease.

Condemnation. Eminent domain proceedings terminate leases. **Foreclosure.**

Foreclosure actions terminate lease obligations.

Death. A tenancy at will terminates on the death of either party. The landlord's death terminates any lease if the landlord held the leased property under a life estate, since the landlord cannot convey an interest that extends beyond the landlord's life.

Security deposit Procedures

As previously mentioned in the context of handling trust funds, state laws, real estate commission rules, and the state’s real estate law, usually specify how a property manager is to manage security deposits. Such funds are normally held in a special trust account and may not be used for any purpose other than the intended one. Whether the deposit can earn interest, and to whom that interest belongs, are likewise prescribed by law. The law also prescribes when the deposit must be returned to the tenant, and under what circumstances any of it may be withheld. The contract language should clearly state the rules, among other things, governing what happens to the deposit when the lease terminates.

Uniform Residential Landlord-Tenant Act

The Uniform Residential Landlord-Tenant Act is model legislation that has been adopted to a greater or lessor extent in many states. In addition to addressing fair and equitable remedies for breaches by both landlord and tenant, the act aims to clarify imprecise language in residential leases that can lead to confusion or exploitation in such areas as:

- lease term
- rental amount
- security deposit
- landlord access
- procedures for default and eviction
- general obligations of landlord and tenant.

See the chapter on "Real Estate Leases" for more detail.

THE MANAGEMENT BUSINESS

Sources of business
Securing business
Professional development

Sources of business

Property management is increasingly a specialization within real estate. There is a growing need for skilled managers because of the increasing number and complexity of properties.

Specialist opportunities. Property managers with specialized training are in demand in a wide variety of property types, including shopping centers, commercial buildings, residential properties, and industrial parks. Within these property specialties are opportunities to specialize even further in such areas as:

- leasing
- asset management
- corporate property management
- resort management
- association management
- housing program management
- mobile home park management
- office building management

Owners and investors in these various property types are among the consumers of management services who represent potential clients for a professional property manager. Such owners and investors may be individuals, corporations, developers, landlords, banks, trusts, homeowners' associations, condominium associations, or investment syndicates

Securing business

Reputation, demonstrated competence, professional training, and smart advertising are keys to finding management business. Before entering into a management agreement, the manager should make sure that the owner's management objectives are clear and that they are realistic.

Management plan. Developing a management plan is a necessary step in beginning a management project, and it may also be part of obtaining a management contract. The manager must consider the owner's objectives, including financial goals; the competitive market for the property, both local and regional, depending on the property type; and the features of the particular property. The plan will take into account market indicators such as vacancy rates, occupancy rates, absorption rates, and new supply coming onto the market. It will also include a budgetary component that considers sources of revenue and anticipated expenses. Finally, the plan will indicate what the manager intends to do with the property, given these considerations, to manage the property in a way that will meet the owner's objectives.

Professional development

A number of organizations provide valuable information and training in subjects related to property management. The certifications and designations provided by these organizations are often viewed as valuable signs of competence and can be a significant factor in getting hired as a manager. Important associations include:

- IREM-The Institute of Real Estate Management, offering the CPM (Certified Property Manager) designation
- BOMA and BOMI-The Building Owners and Managers Association International and the affiliated Building Managers and Owners Institute International, offering the RPA (Real Property Administrator), SMA (Systems Maintenance Administrator), and FMA (Facilities Management Administrator) designations
- NAA-The National Apartment Association, offering designations in apartment building management, maintenance, leasing, portfolio supervision and other related areas
- NARPM-The National Association of Residential Property Managers, offering the RPM (Residential Property Manager), MPM (Master Property Manager) and other related designations
- ICSC-The International Council of Shopping Centers, offering designations in retail property leadership, management, marketing, leasing, and development
- NACM-The National Association of Condominium Managers, offering the RCM (Registered Condominium Manager) designation

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MANAGEMENT FUNCTIONS

- three main types of manager: individual broker or firm managing properties for multiple owners; building manager, employed by an owner or other manager to manage a single property; resident manager, employed by owner, broker, or management firm to live and manage on site.
- manager is a fiduciary of the principal; duty to act in principle's best interests; may specialize in a property type
- needs skills in marketing, accounting, finance, construction; provides financial, physical, administrative services
- specific functions determined by management agreement

Reporting

- may be required monthly, quarterly, annually; include annual operating budget, cash flow reports, profit and loss statements, budget comparison statements

Budgeting

- operating budget based on expected expenses and revenues; determines needed rental rates, capital expenditures, reserves, salaries and wages; projects income based on past performance and current market
- potential gross income: total of scheduled rents plus revenues from other sources; effective gross income: total gross minus losses from vacancies, evictions, uncollected rents; net operating income: effective gross minus operating expenses; cash flow: net operating income minus debt service and reserves
- expenses are variable and fixed**;** capital expenditures are outlays for major renovations and construction; cash reserves set aside for variable expenses

Renting

- manager must keep property properly rented and tenanted; vacancies managed by rent setting, marketing, tenant relations, good service
- selecting compatible tenants and collecting scheduled rents are top priorities
- legal issues concern compliance with fair housing laws, Americans with Disabilities Act, and ECOA

Property maintenance

- main consideration: balance between costs of services, owner financial objectives, and tenant needs
- maintenance may be routine, preventive, or corrective; staffed in-house or contracted out

Construction

- tenant alterations, renovations, and expansion must be managed; also environmental remediation
- legal concerns: Americans with Disabilities Act; applies to employers with fifteen or more employees; manager must determine feasibility of restructuring, retrofitting, new construction, or other alternatives to comply

Risk management

- in managed properties, risk ranges from natural disaster to personal injury, terrorism, and employee malfeasance; risk handled by avoiding or removing the source, installing protective systems, buying insurance, self-insuring (risk retention)
- life safety systems include sprinklers, fire doors, smoke alarms, fire escapes, monitoring systems
- insurance for rented properties includes casualty, liability, workers' comp, fire and hazard, flood, contents, consequential loss, surety bonds, multi-peril
- tenants need their own insurance
- handling of trust funds is a major risk area; mishandling carries heavy penalties

THE MANAGEMENT AGREEMENT

Components	• names of parties; property description; lease term; owner's purpose; responsibilities; authority; budget; allocation of costs; reporting; compensation; Equal Opportunity statement
Rights, duties and liabilities	• landlord: receive rent; receive premises in specified condition; enter and inspect; examine books; enter into contracts, hire vendors, set rents; pay management fee; comply with environmental laws and fair housing
	• manager: hire and fire; enter into contracts; perform management tasks without interference; maintain financial records, make reports, budget, collect rent, find tenants, maintain the property, meet owner goals; liability for trust funds; comply with fair housing laws, credit laws, employment laws

LEASING CONSIDERATIONS

Lease types	• for years, periodic, at will, at sufferance, gross, net, percentage, graduated
Owned and leased inclusions	• items included or excluded in the lease; owner's insurance covers only what is included in the leased property; alterations to inclusions only with owner's permission
	• "inclusion" also refers to financial items included as lessee's responsibility, such as operating expenses
Reversionary rights of owners	• all rights of ownership revert to owner at end of lease term
Landlord rights and responsibilities	• rights: enter premises, receive payment, retake on termination, pursue remedies
	• responsibilities: provide habitable conditions; maintain heating, cooling, electrical, plumbing; keep clean and in repair
Tenant rights and responsibilities	• rights: quiet enjoyment, habitable conditions, right to take action for default
	• responsibilities: pay rent, obey rules, give proper notice, return property in prescribed condition, use only for intended purpose
Evictions	• actual: prescribed legal procedure; notice, suit, judgment, taking of premises
	• constructive: tenant vacates on account of landlord failure to maintain premises
Tenant improvements	• ownership of and payment for improvements according to agreement
Termination of a lease	• causes: expiration, performance, agreement, abandonment, breach, notice, destruction of premises, condemnation, foreclosure, death of either party (tenancy at will), death of landlord (life estate)
Security deposit procedures	• determined by state law, commission rules, and by agreement
Universal Residential Landlord-Tenant Act	• model law regulating lease language and lease terms; adopted by many states

THE MANAGEMENT BUSINESS

Sources of business	• leasing, asset management, corporate properties, resorts, association management, housing programs, mobile home parks, office buildings; owners, investors, corporations, developers, landlords, condo and homeowners' associations, banks, trusts, syndicates
Securing business	• develop reputation and competence; obtain training; use effective advertising; make management plan in accordance with owner objectives
Professional development	• training, designations, certifications increase and demonstrate competence