Leases

A lease is both a method of conveyance and a contract. A lease conveys a less than-freehold (leasehold) estate from the owner (the landlord) to the tenant. As we discussed in Chapter 3, the holder of a leasehold estate does not own the property, but rather has a right to exclusive possession of the property for a specified period of time. Sometimes the landlord and the tenant are said to be “in privity,” which means they have a mutual interest in one property.

A lease (also called a rental agreement) sets out the rights and responsibilities of the two parties, the landlord and the tenant. In addition, certain covenants and obligations are implied by law in all leases, whether or not they are part of the agreement.

Requirements for a Valid Lease

As with any contract, the parties to a lease must be competent and must both agree to its terms. Consideration (typically, the rental payment) is also required. The amount of the rent and when it is due should be specified.

Under the statute of frauds, a lease must be in writing if the lease term is longer than the statutory period (one year in most states). A lease for a fixed term that should be in writing but is not may be treated as a periodic tenancy instead.

A written lease must be signed by the landlord. The tenant usually signs the lease as well, but the tenant’s signature isn’t always required. A tenant who takes possession of the property and pays rent is considered to have accepted the terms of the lease. Even so, it’s wise to have both parties sign the lease. Also, since a lease is a contract pertaining to real property, a complete and accurate description of the property should be included.
Lease Renewal

A lease may contain a provision that gives the tenant an option to renew the lease at the end of the term. Most renewal options require the tenant to give notice of her intention to exercise the option on or before a specific date.

To renew a lease, the parties often sign a renewal agreement. But a lease may be renewed by implication rather than express agreement. When the tenant makes a lease payment after the lease has expired, and the landlord accepts the payment, that can be considered an implied renewal of the lease.

Transferring Leased Property

A landlord can sell the leased property during the term of the lease, but the buyer takes title subject to the lease. This means the buyer must honor the lease for the remainder of its term. (There’s an exception if the property is sold involuntarily. A foreclosure sale purchaser doesn’t necessarily have to honor an existing lease.)

The tenant can also transfer his leasehold estate to another party, through assignment, subleasing, or novation. The tenant has the right to assign or sublease without the landlord’s consent, unless the lease provides otherwise. A novation always requires the landlord’s consent.

In an assignment, the tenant transfers the entire unexpired term of the lease.

Example: Landlord leases the premises to Tenant for a period starting January 1, 2013 and ending June 30, 2016. On July 1, 2013, Tenant leases the premises to XYZ Corporation for a term starting July 1, 2013 and ending June 30, 2016. The agreement between Tenant and XYZ is an assignment, because the transfer is for the balance of the unexpired term.
The assignee becomes liable for paying the rent to the landlord (the original lessor) and the assignor (the original tenant) becomes secondarily liable for the rent. This means that the assignee has the primary responsibility for paying the rent, but the original tenant is not fully released from the duty to pay.

In a sublease, the original tenant transfers only part of his remaining interest. He may be giving the subtenant (the new tenant) the right to share possession with him, or the right to possess only part of the leased property. Or he may be giving the subtenant the right to possess the whole property, but for only part of the unexpired term.

**Example:** Landlord leases the premises to Tenant for a period starting January 1, 2013 and ending June 30, 2016. On July 1, 2013, Tenant leases the premises to a subtenant for a period starting July 1, 2013, through June 30, 2015, reserving the last year for himself. This agreement is a sublease because the tenant has transferred less than the balance of the lease term.

The subtenant is liable for the rent to the original tenant, rather than to the landlord, and the original tenant is still liable to the landlord. This situation is sometimes referred to as a **sandwich lease**, because the original tenant is in the middle, sandwiched between the landlord and the subtenant.

A novation occurs when a new contract is created and the old contract is extinguished. When an existing lease is replaced either with a new lease between the same parties, or with a new lease between
different parties, it has been novated. The purpose of a novation is to terminate the liability of the tenant under the original lease.

**Termination of a Lease**

Most leases terminate when the lease term expires and the lease is not renewed. A lease may also be terminated before the end of its term in a variety of ways.

**Surrender.** A landlord and tenant may mutually agree to terminate a lease before the scheduled end of the lease term. This is called surrender. Note that the tenant cannot simply abandon the property in order to get out of the lease. A surrender requires the agreement of both parties.

**Actual Eviction.** When the landlord expels the tenant from the property, this is called actual eviction. However, the landlord cannot simply force the tenant to leave the property. To protect residential tenants, state laws impose a number of requirements on a landlord that wants to terminate a tenant’s lease rights. (State landlord/tenant laws are covered in Chapter 17.)

A landlord trying to evict a tenant must take the tenant to court and give the tenant notice of the eviction proceeding. In the court hearing, the landlord must show evidence of the tenant’s violation of the lease agreement. The most common reason for eviction is failure to pay rent.

If the tenant refuses to leave when requested, the landlord must go through the legal process. Landlords should never take matters into their own hands. A landlord who tries a “self-help” eviction (forcing the tenant out with threats, or by cutting off the utilities) instead of the legal process may end up defending a costly lawsuit.

**Constructive Eviction.** Every lease has an implied promise from the landlord to the tenant that he will refrain from unlawfully interfering with the tenant’s possession of the leased property. This is known as the **covenant of quiet enjoyment**. Constructive eviction occurs when the landlord causes or permits a substantial interference with the tenant’s possession of the
property. In these circumstances, the tenant may be justified in abandoning the property and terminating the lease. Other remedies, such as suing for damages or withholding rent payments, may also be available.

Most states require a residential landlord to maintain the property in a habitable condition and make necessary repairs. For example, failure to provide heat to a residential unit in the wintertime has been found to result in constructive eviction. The specific obligations of landlords and tenants will be discussed more specifically in Chapter 17.

**Illegal or Unauthorized Use.** If the tenant uses the premises in an illegal manner (in violation of the zoning code, for example) or in a manner not authorized by the lease, the tenant has violated the agreement. Depending on the provisions of the agreement, the landlord may be able to terminate the lease.

Even though the lease is terminated, if the tenant remains on the property, she is still a tenant at sufferance (see Chapter 3). The landlord will need to go to court in order to evict the tenant and recover possession of the property.

**Foreclosure.** If a lien against leased property is foreclosed on because the landlord has defaulted on a loan or other obligation, the foreclosure may terminate the lease. Generally, a foreclosure sale purchaser must honor an existing lease only if it has higher priority than the foreclosed lien.

A federal law passed in 2009 provides tenants of foreclosed properties with some additional protections. Under this law, someone who buys leased residential property at a foreclosure sale is required to honor the lease for the remainder of its term, unless the buyer herself intends to occupy the property as a personal residence. In that case, the buyer must give the tenant 90 days' notice before terminating the tenancy. A residential tenant who doesn’t have a lease for a specific term (for example, if it’s a month-to-month tenancy) is also entitled to 90 days' notice, whether or not the buyer is planning to move into the home herself. Although this federal
law is scheduled to expire at the end of 2014, it's possible that Congress will extend it temporarily or permanently.

**Destruction of the Premises.** In most states, if a lease is for the use of an entire building, it is presumed to include the land as well. Unless the agreement provides otherwise, the destruction of the building does not terminate the lease. The tenant is not prevented from use and enjoyment of the land, and therefore the purpose of the lease is not frustrated. The tenant will not be relieved from the duty to pay the rent to the end of the rental period. If, however, the lease is only for a part of a building, such as an office, apartment, or commercial space, the destruction of the building frustrates the entire purpose of the lease, so the tenant will be released from the duty to pay rent.

**Condemnation.** Condemnation of property can also result in premature termination of a lease. (See Chapter 6 for a discussion of condemnation and the power of eminent domain.)

(Rockwell, 196-199)

**Property Management**

Many brokerage offices engage in property management to some degree, so all real estate agents should have a basic knowledge of property management principles. This chapter gives the reader an overview of the property management profession. The first section of the chapter discusses the basics of investing in real estate. The next section describes some of the differences between types of managed properties. After that, we'll discuss the management agreement, the management plan, and the various functions of a property manager. The final section of the chapter will look at the laws that govern landlord/tenant relationships.

**Introduction to Property Management**

Property management refers to a situation in which a person other than the owner supervises the operation of income property in exchange for a fee. Prior to the 1930s, real estate owners usually managed their own
properties, although sometimes they hired assistants to collect rents. Then in the 1930s, during the Great Depression, countless borrowers defaulted on their mortgages and many properties ended up in the hands of lenders. These lenders were saddled with management responsibilities for extensive property holdings, but they had little property management experience. In response, some formed their own property management departments, and others came to depend on the real estate industry to provide the necessary expertise. Although the lenders eventually resold the properties they acquired during the Depression, the value of efficient property management had been discovered, and increasing numbers of property owners began to use the services of property managers.

In the years following World War II, property management became even more important as construction and business practices changed. Apartment and office buildings became larger as elevators and steel framing allowed the construction of multi-story structures. Shopping centers replaced the corner store and flourishing commercial activity led to the creation of industrial parks. It became increasingly difficult for property owners to manage all of their holdings, and professional, efficient, and effective outside management became a necessity rather than a luxury.

Today, property managers work in a number of different contexts. Although many work for property management companies, property managers may also be employed directly by owners as independent contractors. In addition to managing residential apartment buildings and commercial complexes, property managers are often hired to manage community associations for planned unit developments, investment syndicates, and condominium and homeowners associations.

**Licensing and Professional Organizations**

Generally, state law requires a property manager to be licensed either as a real estate agent or specifically as a property manager; the requirements vary from state to state. Many property managers join management professional organizations. For example, a property manager may obtain the
designation of Certified Property Manager (CPM) or Accredited Residential Manager (ARM) upon successful completion of courses in property management and residential management from the Institute of Real Estate Management (IREM), a division within the National Association of REALTORS®.

The Building Owners and Managers Institute International (BOMI) is an organization that provides educational programs for commercial property management. BOMI offers several designations related to property management, including Real Property Administrator (RPA), Systems Maintenance Administrator (SMA), and Facilities Management Administrator (FMA).

Investing in Real Estate

A property manager’s job begins after someone has decided to invest in income producing property, such as an apartment building, office building, or shopping center. As you will learn, the primary function of a property manager is to help the property owner achieve his investment goals. So before discussing the nuts and bolts of property management, let’s take a brief look at general investment principles and at real estate as an investment. (A word of caution: real estate agents should not act as investment counselors; they should always refer clients to an accountant, attorney, or investment specialist for investment advice.)

An investment is an asset that is expected to generate a return (a profit). A return on an investment can take various forms, including interest, dividends, or appreciation in value. An asset appreciates in value because of inflation, and may also appreciate because of a rising demand for the asset. For example, a parcel of prime vacant land often appreciates quickly as developable land becomes increasingly scarce.
Types of Investments

Investments can be divided into two general categories: ownership investments and debt investments. With ownership investments, the investor takes an ownership interest in the asset. Real estate and stocks are examples of ownership investments. The return on ownership investments usually takes the form of dividends, rent, and/or appreciation.

A debt investment is essentially a loan that an investor makes to an entity. For example, a bond is a debt owed to an investor by a government entity or corporation. The investor lends the entity money for a set period of time, and in return the entity promises to repay the money at a specific date (the maturity date) along with a certain amount of interest.

Investors often choose to diversify their investments—that is, they choose to invest in a variety of different types of investments. The mix of investments owned by an individual or company is referred to as a portfolio.

Note that for tax purposes, investment income (such as interest, dividends, or rent) is sometimes distinguished from earned income (salaries, wages, or self-employment income).

Investment Characteristics

An investor considers any investment in terms of three potential advantages: liquidity, safety, yield (which is the total return on the investment, or ROI). These three characteristics are interrelated. For example, liquidity and safety generally go together. On the other hand, for a high return an investor often sacrifices safety or liquidity, or both.

Safety. An investment is considered safe if there’s little risk that the investor will actually lose money on it. Even if the investment doesn’t generate the return she hopes for, the investor will at least be able to recover the money she originally invested.
Some types of investments are very safe, because they carry a guarantee. The federal deposit insurance that protects funds (up to $250,000) in a bank account is a simple example; it’s highly unlikely that a depositor will lose any of the money he puts in the bank. On the other hand, some types of investments are inherently risky. For instance, an investor who puts his money into an uncertain venture such as a brand new company is likely to lose his investment if the company isn’t a success.

**Liquidity.** A liquid asset is one that can be converted into cash quickly. Money in a bank account is extremely liquid: to convert it into cash, the investor need only present the bank with a withdrawal slip or check. Mutual funds, stocks, and bonds are less liquid—they take a little longer (perhaps a few days) to convert into cash. Other items, such as jewelry or coin collections, are not considered liquid at all, because an investor might have to wait months to exchange those assets for cash. Real estate isn’t a liquid asset.

As a general rule, the more liquid the asset, the lower the return. For example, the money in an ordinary savings account is very liquid, but it offers only a modest return, in the form of a low rate of interest. If you make a commitment to keep the funds deposited for a specified period (with a certificate of deposit), you’ll get a slightly higher rate. The longer the period, the higher the rate.

Liquidity is an advantage because the investor can cash in the investment immediately if the funds are needed for an unexpected expense, or because a better investment opportunity has arisen. Money in a nonliquid investment is effectively “locked up” and unavailable for other purposes. Real estate and other nonliquid assets can be excellent investments, but their lack of liquidity has consequences that a prospective investor should take into account.

**Yield.** Investments that are both safe and liquid tend to offer the lowest returns. In a sense, investors “pay” for safety and liquidity with a low return. To get a high return, an investor usually must take the risk of losing some or
even all of the money originally invested. The investor may also have to sacrifice liquidity, allowing the money to be tied up for a while.

Of course, except with the very safest investments, the yield isn’t fixed at the time the investment is made. The yield can change with market conditions, such as an increase or decrease in market interest rates.

As a general rule, the greater the risk, the higher the potential yield needs to be. Otherwise investors won’t be willing to make the investment. Investors also expect higher yields from long-term investments, as compensation for keeping their money tied up for longer periods of time.

With some types of investments, the return will be much greater if the investor can afford to keep the investment for a long period of time and take advantage of healthy market conditions. This is true of real estate.

**Example:** Jeanne and Harold each buy a piece of land for $20,000 in the same year. One year later, Jeanne desperately needs some cash. The market for land has taken a downturn, and Jeanne is forced to sell her property at a loss. She ends up with only $17,000 of her original $20,000 investment.

Harold, on the other hand, is in no hurry to sell the property, so he can wait for optimal market conditions. He keeps the land for twelve years and then sells it at the peak of a real estate cycle, when property values are high. Because Harold could afford to choose when he sold the property, he walks away from the transaction with $60,000, an excellent return on his original $20,000 investment.

**Advantages of Investing in Real Estate**

People invest in real estate for many reasons. The advantages of investing in real estate can be broken down into three general categories:

- appreciation,
- leverage, and
- cash flow.

**Appreciation.** Appreciation refers to an increase in a property’s value due to changes in the economy or other outside factors. Although real estate values may fluctuate, over a period of several years real estate usually increases in value at a rate equal to or higher than the rate of inflation. Thus, real estate is considered an effective hedge against inflation. And when buildable property becomes scarce, the value of properties in prime locations increases even more rapidly.

Appreciation causes a property owner’s equity to increase. **Equity** is the difference between the value of the property and the liens against it, so an increase in the property’s value increases the owner’s equity in the property. Also, each monthly mortgage payment increases the owner’s equity, in proportion to the reduction of the principal amount of the loan. Equity adds to the investor’s net worth and can also be used to secure a home equity loan. So even though real estate is not considered a liquid asset, equity in real estate can be used to generate cash funds.

**Leverage.** Leverage is the use of borrowed money to invest in an asset. If the asset appreciates, then the investor earns money on the funds borrowed as well as the money she invested.

**Example:** Martin purchases a rental home for $215,000. He makes a $43,000 down payment and borrows the rest of the purchase price. The rent generated by the property covers all the expenses of operating the property, plus the mortgage payment and income.
taxes. The property appreciates at 3% per year for five years. At the end of the five years, Martin sells the property for $249,000. He’s made a $34,000 profit over five years on his $43,000 investment. This represents a 79% return over the five-year period. The property appreciated at 3% per year, but because he invested only 20% of the purchase price, Martin was able to generate a 79% return on his investment.

**Cash Flow.** Many real estate investments generate a positive cash flow, as well as appreciate in value. Cash flow is defined as spendable income—the amount of money left after all the property’s expenses have been paid, including operating costs, mortgage payments, and taxes. When a real estate investment generates a positive cash flow, the investor’s monthly income increases. Thus, a real estate investment can increase both the investor’s net worth (through appreciation) and his income (through positive cash flow).

Another way in which a property can generate cash flow is through a **sale lease back** arrangement. In a sale-leaseback, the owner of a building (typically a commercial property) sells the building to an investor, but then leases the property back from the investor and continues to use it. The money generated by the sale can be used for expansion, acquiring inventory, or investment elsewhere. At the same time, the seller can deduct the rent paid to lease the property from her income taxes as a business expense. Sometimes a sale-leaseback arrangement also includes a **buyback** agreement, in which it’s agreed that the seller will buy the property back for its fair market value after a certain number of years.

Investors sometimes use the term “cash on cash,” which refers to a property’s first year cash flow divided by the initial investment. It pinpoints the ratio between cash invested (equity) and cash received.
Disadvantages of Investing in Real Estate

Of course, real estate investments can be a mixed blessing. There are some disadvantages to real estate investments that must be considered carefully.

First, real estate investment often requires expert advice. Investing in real estate is typically far more complicated than putting money in a savings account or a mutual fund. It is also more time-consuming. Not only does the initial purchase take time and effort, but the property must be managed after it is purchased. Rental rates must be set, tenants found, rents collected, and maintenance and repairs completed. Even if the investor decides to hire a property manager to manage the property, there are many decisions that must be made by the investor.

As we discussed earlier, real estate investments are not liquid. Time is required to convert real estate into cash. Furthermore, there are substantial risks involved in investing in real estate. There is no guarantee that the investor won’t lose some or all of the down payment. For instance, there is always the chance that the property’s value may decline because of a local economic trend.

Example: On a national scale, property values are keeping pace with inflation. However, Lumbertown relies solely on the timber industry and the local lumber mill for employment. When the local mill shuts down, the town is economically crippled. Even though real estate is usually a good investment, property values in Lumbertown decline rapidly.

Also, the income generated by a property may not be enough to cover the expenses of operating the property. A negative cash flow may force the investor to sell the property quickly, for less than she paid for it.
Types of Managed Properties

Now let’s consider the different types of properties that a property manager may be called upon to manage. There are four basic types of income-producing properties:

1. residential rental property,
2. office buildings,
3. retail property, and
4. industrial property.

Each type of property has its own unique characteristics and management needs. Because each type of property demands a different kind of expertise, property managers often specialize in one particular type of property. The following are a few examples of the differences between property types.

Apartment buildings, which typically offer six-month or one-year leases, have a much higher turnover rate than industrial property, where leases often run for ten years or more. As a result, residential property managers tend to spend more of their time marketing and leasing out space. Residential property managers also must fulfill the legal responsibilities imposed by the landlord-tenant laws, which are designed to protect the health and well-being of residential tenants.

Property managers are also often hired by community or homeowners associations to manage the common property and services of condominiums,
cooperatives, and planned communities. The property manager is responsible for collecting association dues, as well as ensuring compliance with association rules and covenants.

Office buildings have very different housekeeping requirements than residential buildings: they endure much heavier foot traffic; they have facilities (such as washrooms and elevators) that get continuous use and thus need frequent cleaning; and management is often responsible for cleaning the tenants’ spaces as well as the common areas. Lease negotiations are also very different for office buildings than for residential space: rent is based on a price per square foot (rather than per unit); the leases are for longer periods of time and usually include some type of escalation clause (to provide for automatic increases in rent); and landlords commonly offer major concessions to attract tenants, such as free rent for a limited period or extensive remodeling.

Leasing space to an appropriate tenant is a concern with any type of property, but it is especially important when managing a shopping center. The success of each tenant in a shopping center depends in part on the customers that each of the other tenants attract, so it is vital to lease to strong tenants. Also, a portion of the rent is often based on the tenant’s income, so the owner has a vested interest in the financial success of each tenant. The tenant mix must appeal to the widest variety of potential shoppers, while avoiding direct competition within the shopping center itself.

These are only a few of the ways in which property types differ. Even from such a small sampling, however, it is easy to see that different management plans are required for each type of property. The benefits of specializing in one or two property types are evident.

Our discussion will focus mainly on managing residential properties, but most of the principles and practices we’ll be describing apply to the management of any type of property.
The Management Agreement

The first step in the management process is entering into a management agreement. The management agreement establishes the working relationship between the property manager and the property owner. In the same way that a listing agreement creates an agency relationship between a broker and a seller, the management agreement creates an agency relationship between the manager and the owner.

The management agreement must be in writing and signed by both parties. It is very important that the written document contain all the terms and conditions of the agreement. It is especially important that the exact duties and powers of the manager be explicitly stated. What kinds of decisions can the manager freely make, and what kinds must be referred to the owner? For example, suppose several units in an apartment building needed new carpets. Could the manager replace the carpets without consulting the owner, or is this a decision that the owner wants to make? Other areas in which questions might arise include the authority to execute leases, make major repairs, choose an insurance company and policy for the property, or embark on a major advertising campaign.

At a minimum, the following points should be included in the management agreement:

- the term of the agreement;
- the manager’s compensation (a percentage of gross income, a commission on new rentals, a fixed fee, or a combination of all of these);
- the type of property;
- the legal description of the property;
- the number of units or square footage;
- whether the manager is authorized to collect and disburse funds, and if so, for what purposes;
- whether the manager is authorized to hold and disburse tenant security deposits; and
provisions concerning the manager’s reports to the owner, specifying
the frequency and level of detail of the reports.

In most cases, these additional provisions should also be included in the
management agreement:

• a description of other management responsibilities (duties should be
  stated, exceptions noted);
• a statement of the owner’s goals (for example, to maximize income, or
to increase the capital value of the property);
• the extent of the manager’s authority (for example, fixing rental rates,
hiring and firing, authorizing repairs); and
• allocation of costs (which expenses the manager will pay and which
  expenses the owner will pay—such as office help, advertising, or
  telephone expenses).

The property manager must bear in mind that after the management
agreement is signed, an agency relationship exists between the manager
and the owner, and thus the manager is bound by all the duties and
responsibilities of an agent (see Chapter 9).

The Management Plan

Once a manager has entered into a management agreement, the actual
business of managing begins. The first (and often most important) step in
managing a property is drawing up a management plan. A management plan
outlines the manager’s strategy for financial management and physical
upkeep, and focuses on achieving the owner’s goals.

The management plan should implement the owner’s goals in the most
effective manner possible. It is important to remember that there are many
different reasons for investing in income property—different property owners
have different management goals. For instance, one property owner may
simply want a steady, reliable stream of income. Another owner may want a
tax shelter. Another may want to increase the property’s value in order to
reap a bigger profit in later years. An owner's goals can also change over the period of ownership.

**Example:** When he’s in his early forties, Greg decides to purchase a small apartment building. He has other sources of income, so he is most interested in the long-term investment and tax shelter aspects of real estate ownership. However, as the years pass, Greg’s needs change. When he retires, he is suddenly more interested in receiving a steady cash flow from his property.

**Preliminary Study**

A management plan can be created only after a comprehensive study of all of the facets of the property, including its location, its physical characteristics, its financial status, and its policies of operation. This preliminary study includes a regional analysis, a neighborhood analysis, a property analysis, and a market analysis.

**Regional Analysis.** Preparing a management plan begins with a study of the region (city or metropolitan area) in which the property is located. The manager analyzes the general economic conditions, physical attributes, and population growth and distribution. Among the most significant considerations are trends in occupancy rates, market rental rates, employment levels, and (for residential property) family size and lifestyle.

**Occupancy Rates.** According to the law of supply and demand, when the demand for an item is greater than the supply, the price or value of the item increases. And when the supply exceeds the demand, the price or value of the item decreases. This basic rule applies to rental properties just as it applies to other commodities.

From a property manager's point of view, the supply of rental units is the total number of units available for occupancy in the area where the managed property is located. The demand for rental units is the total number of potential tenants in that area who are able to pay the rent for those units.
When demand exceeds supply, rental rates go up; when supply exceeds demand, rental rates go down.

There is a **technical oversupply** of property when there are more units than potential tenants. There is an **economic oversupply** when there are enough potential tenants, but they are unable to pay the current rent. Likewise, there may be a **technical shortage** (when there are more potential tenants than units) or an **economic shortage** (when there are more able-to-pay tenants than units).

To set rental rates for a managed property, a property manager must determine the occupancy trend for the area. If the trend is toward higher occupancy levels, the value of the units will increase because space is becoming more scarce. It is during these times that managers raise rents and reduce services. On the other hand, if there is a trend toward higher vacancy rates, a unit’s value will decrease. In periods of high vacancy, tenants are likely to resist rent increases or make more demands for services or repairs when leases are renewed.

Occupancy levels are constantly fluctuating. The direction and speed in which they are moving will have a significant impact on the property manager’s operating and marketing policies.

**Market Rental Rates.** In addition to evaluating occupancy trends, a property manager should keep track of market rental rates (the rates currently being charged for comparable rental units). The market rental rate for a unit is also called **economic rent**. **Contract rent** is the amount a tenant must pay the owner under the terms of a current lease. The manager should set rental rates for the managed units at a level that will enable them to compete in the current market.

There are published reports that provide information about rental rates, such as the Bureau of Labor’s statistics on rents paid for residential units. A property manager may also evaluate the properties that he is managing to determine the average monthly rent per unit or square foot. Statistics kept by an individual property manager can be combined with statistics kept by
other managers in the area to get a broader perspective. Rental rates stated in classified ads can also be considered. These methods, while not precise, can give a manager a basic picture of market trends.

**Employment Levels.** The property manager should be aware of local employment trends, since employment levels affect how many potential tenants can afford to rent. A property manager should also know whether earnings are increasing or decreasing, and about savings rates in the community. Clearly, if potential tenants cannot afford a particular rental unit or would rather save than spend, the property manager’s product is not going to be sold.

**Family Size and Lifestyle.** Family size has a great deal to do with the value of particular residential units. If the average family size were three (two parents and one child), five-bedroom units would have little appeal and two-bedroom units would be very attractive. Thus, the two-bedroom units would command a higher price per square foot than the five-bedroom units. A property manager needs to be aware of the national trend toward smaller and even single-person households, and also any local trends in family size and lifestyle.

**Neighborhood Analysis.** After the regional analysis, the next step in the preliminary study is to analyze the specific neighborhood where the property is located. The definition of a neighborhood varies considerably from one place to another. In rural areas, a neighborhood may consist of many square miles. In an urban area, a neighborhood may be only a few blocks.

The qualities of the neighborhood have a significant bearing on the property’s value and use. Important neighborhood characteristics include:

- the level of maintenance (Are the buildings and grounds well cared for, or in poor condition?);
- a growth or decline in population; and
- the economic status of the residents.
A property manager should discover the reasons behind any neighborhood trends. Is the population density increasing because of further development or because single-family homes are changing into rooming houses? Development is a sign of economic prosperity; rooming house tenancies are not.

A neighborhood analysis helps a property manager factor location into the management plan. No matter how effectively a property is operated, its profitability will be strongly affected by its location. Once the characteristics of the location have been determined, realistic management goals can be set.

**Property Analysis.** Of course, to develop a management plan the manager must become very familiar with the physical characteristics of the property itself. She will inspect the property, noting its architectural design, physical condition, facilities, and general layout.

The following characteristics are particularly important:

- the number and size of the living units, or the number of rentable square feet;
- the appearance of the property and the rental spaces (age, architectural style, layout, view, fixtures, etc.);
- the physical condition of the building (roof, elevators, windows, etc.);
- the physical condition of the rental spaces (floor coverings, stairways, shades or blinds, walls, entryways);
- the amenities provided (laundry room, recreational facilities, etc.);
- the services provided (janitorial services, repair services, or security);
- the relationship of the land to the building (Is the land used efficiently? Is there adequate parking?);
- the current occupancy rate and tenant composition; and
- the size and efficiency of the current staff.
**Market Analysis.** The last step in the preliminary study for a management plan is the market analysis, which provides information on competing properties. To do a market analysis, the manager must first define the pertinent market. The major divisions of the real estate market are residential, commercial, retail, and industrial. Each of these can be broken down into subcategories. For instance, the residential market can be divided into single-family rental homes, duplexes, townhouses, walk-up apartments, small multi-story apartments, and large apartment complexes.

Once the manager has identified the market that the managed property competes in, there are several characteristics that must be examined:

- the number of units available in the area;
- the average age and character of the buildings in which the units are located;
- the quality of the average unit in the market (size, condition, layout, facilities, etc.);
- the number of potential tenants in the area;
- the current price for the average unit; and
- the occupancy rate for the average unit.

The property manager compares the managed property to comparable properties in the neighborhood. In this way, the manager can evaluate what the property has to offer and what its disadvantages are. Armed with this information, the manager can establish an effective management strategy.

**The Management Proposal**

After completing the preliminary study, the property manager develops a management proposal and submits it to the property owner for approval. The manager's proposal will include a rental schedule, income and expense projections, a schedule of day-to-day operations, and perhaps suggestions for physical changes to the property itself.
### Fig. 17.3 Operating budget form

#### Operating Budget

<table>
<thead>
<tr>
<th></th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
<th>Apr</th>
<th>May</th>
<th>June</th>
<th>July</th>
<th>Aug</th>
<th>Sept</th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
<th>Annual</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scheduled Rents</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vacancies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rent Loss</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Effective Rent</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Miscellaneous</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administrative</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management Costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Adm. Costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payroll</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supplies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Heating</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electricity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Water and Sewer</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gas</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maintenance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grounds</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maint. and Repairs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Painting, Decorating</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxes and Insurance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real Estate Taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Taxes, Fees</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contract Service</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Operating Income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less Reserves</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less Debt Service</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cash Flow</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
**Rental Schedule.** A rental schedule is a list of all the rental rates assigned to the different types of units. For example, an apartment building may consist of studio apartments, one-bedroom apartments, and two-bedroom apartments. Some apartments may have views, others may not. A rental schedule lists the various types of units and their rental rates.

Rental schedules are based on all the data collected during the regional, neighborhood, property, and market analyses. This information helps the manager determine the optimum rent that can be charged while maintaining the optimum occupancy level. To set the rate for a particular type of unit, the manager can adjust the market rental rate for the average comparable unit up or down to reflect the differences between the comparable and the type of unit in question. Because this method of setting rates depends on market conditions, the rental schedule should be reexamined periodically to see if it is current. Either an unusually high vacancy rate or an unusually low vacancy rate is an indication that the property’s rental rates are out of line with the community. If the vacancy rate is too high, the rent may be too expensive; if the vacancy rate is unusually low, the rent may be below the norm.

**Budgets.** The property manager also sets up a budget of income and operating expenses (see Figure 17.3). The manager lists the total value of all rentable space at the scheduled rental rates, then subtracts a figure for delinquent rental payments and vacancies (sometimes called a bad debt and vacancy factor). Any other income sources, such as laundry facilities, vending machines, or parking, should also be listed.

Next, the estimated operating expenses—both fixed expenses and variable expenses—are listed. **Fixed expenses** include such items as property taxes, insurance premiums, and employee salaries. **Variable expenses** include utilities, maintenance, and repairs. Finally, the manager deducts projected operating expenses from projected revenues to arrive at a cash flow figure.
Day-to-Day Operations. In addition to long-range financial planning, the management proposal should include the manager’s plans for the day-to-day operations of the property. This means that the manager has to decide how much (if any) staffing will be required and what the employment policies and procedures will be.

Physical Alterations. In some cases, the property manager’s proposal will include recommendations for remodeling, rehabilitation, or other physical alterations to the property. For instance, after a thorough examination of the property, the customer base, and the market, a manager might decide that the property would be worth much more to the owner if the building were altered to match current family size and lifestyle trends.

Example: An older building is made up of four- and five-bedroom units in a neighborhood predominantly made up of one- and two-person households. If the apartments were converted to smaller units, the owner’s profits would probably increase significantly.

Owner’s Approval. Once completed, the management proposal is presented to the property owner. When the proposal is approved, it becomes the management plan: the blueprint for managing the property.

Management Functions

Property managers must possess the skills necessary to perform a variety of management functions. They must be able to market the property, negotiate leases, and handle tenant relations. They must be able to keep and understand detailed financial records and report to the property owner on a regular basis. They must also be able to arrange for the maintenance and repairs that will preserve the value of the property.

Leasing and Tenant Relations

The property manager’s tasks involved in leasing and tenant relations include marketing the rental spaces, negotiating leases, addressing tenants’ complaints, and collecting rents.
Marketing. The more people who view a rental space, the more likely it is to be rented out. So property managers generally use advertising to bring potential tenants to their properties.

Different types of properties require different types and amounts of advertising. For some properties, advertising is necessary only when there is a vacancy to fill. If the property is in a prominent location and attractive to potential tenants, advertising may not be necessary at all. On the other hand, if the property is in an isolated location, continuous advertising may be required to generate enough interest to fill vacancies when they occur.

Successful advertising brings in a good number of potential tenants in the least amount of time for the lowest cost. Property managers often evaluate the effectiveness of their advertising in terms of the number of potential tenants for the advertising dollars spent. For example, based on experience, a property manager might have a general rule of thumb that the cost of advertising should not exceed $25 to $35 per prospect. Thus, newspaper advertising that costs $300 should bring in 9 to 12 prospective tenants to the property.

To reach the greatest number of potential tenants for the lowest possible cost, the property manager must be familiar with the various types of advertising and know which will be most effective for the property in question. The manager may consider using signs, newspaper ads, Internet advertising and websites, radio or television spots, direct mail, or some combination of these tools.

Signs. Small, tasteful signs are often used, whether there is a vacancy or not, to inform passersby of the name of the manager and how to acquire rental information. The use of signs is most successful for office buildings, large apartment complexes, and shopping centers.
Newspaper Advertising. Newspaper advertising includes classified ads and display ads. Classified ads (inexpensive line type advertising that appears in the “classified” section of the newspaper) are a popular way to advertise residential rental space. Display ads are larger and more expensive than classified ads. A display ad often includes a photograph of the property, and it may appear in any section of the newspaper. Display advertising is generally an effective way to advertise space in a new office building, industrial park, or shopping center.

Internet Advertising. Classified ads can also be placed on the Internet, through online advertising websites. Internet classifieds have a number of advantages over newspaper classifieds; for example, they can include photographs of the property, and many websites allow listings to be posted free of charge.

Depending on the scope of her business, a property manager may want to maintain her own website to advertise all of the properties she’s managing. In some cases, a website dedicated to a particular apartment complex, office building, or other property may be worthwhile.

Radio and Television. Property managers occasionally use radio and television ads for large commercial and residential properties. Although broadcast advertising reaches a large audience, there usually aren’t many potential tenants in the audience. Since broadcast advertising (especially
television advertising) is quite expensive, it generally isn't cost-effective for most rental properties.

**Direct Mail.** To be effective, direct mail advertising must be received by potential tenants, not just the general public. So a property manager who wants to use direct mail must compile or purchase a mailing list. With a good mailing list and a brochure designed to appeal to prospective tenants, direct mail can be an effective means of advertising. Also, the same brochure can be handed out to those who visit the property.

**Leasing.** A prospect has seen an advertisement and comes to look at the available rental space. Now it is the property manager’s job to convince the prospect that the rental space is desirable. They will usually tour the property together, and during the tour the manager will emphasize all of the property’s positive qualities and all of its amenities. The manager will point out traffic patterns and access to public transportation, the characteristics of the other tenants, the exterior and interior condition of the property, and its overall cleanliness. If it’s commercial property, the manager and the prospect may discuss how the space could be altered to suit the prospect's needs.

After the tour, if the prospect is still interested in the property, it is the property manager’s responsibility to make sure that the prospect is qualified to lease it. Although financial stability is a key consideration, it’s not the only one. The manager must also decide whether the prospect is likely to be a responsible and cooperative tenant. At a minimum, this will involve checking the prospect’s references and contacting the previous landlord. The manager can also use his own judgment, but must be very careful to avoid violating antidiscrimination laws (see Chapter 16).

If the manager decides in favor of the prospect, the next step is to execute a rental agreement or lease. The requirements for a valid lease are explained later in this chapter, in the discussion of landlord/tenant law.
**Lease Renewal.** Unless the tenant has caused problems, a property manager would much rather renew an existing lease than find a new tenant. Renewal avoids a vacancy between the time one tenant moves out and another moves in. A building has greater stability with long-term tenants, and it is usually easier and less expensive to satisfy the requirements of an existing tenant than improve the space for a new tenant.

A property manager should always be aware of which tenants are nearing the end of their lease terms and notify them that their leases are about to expire. Then the manager should follow up on the notices, by phone or in person, to inquire whether the tenant wants to renew. If the tenant is going to renew the lease, the terms of the new lease must be negotiated.

Some leases contain an **automatic renewal clause**, which provides that the lease will be automatically renewed on the same terms unless one party notifies the other of her intent to terminate the lease.

**Tenant Complaints.** Of course, keeping tenants happy is an important part of the property manager’s job. Making sure that the property is kept clean and in good repair is essential, and so is responding promptly and professionally to requests and complaints. A property manager’s ability to keep tenants happy is directly related to the management-unit ratio, which is the number of units per on-site manager. Generally, one on-site manager can handle 50 to 60 units.

**Rent Collection.** Rental property cannot be profitable unless the rents are collected when due. Careful selection of tenants in the first place is one of the most effective ways of avoiding delinquent rents. A high occupancy rate doesn’t benefit the property owner unless the tenants are likely to meet their financial obligations.

The amount of the rent, the time and place of rent payment, and any penalties imposed for late payment should be clearly stated in the lease. The manager should consistently follow a collection plan that includes adequate recordkeeping and immediate notification of late payments. When
all collection attempts fail, the manager must be prepared to take legal action to evict the tenant in accordance with the owner’s policies.

![Rent Roll](image)

### Recordkeeping and Manager/Owner Relations

A property manager must account to the owner for all money received and disbursed. It is up to the owner to decide how frequent and detailed operating reports should be. This often depends on how involved the owner wants to be in the management of the property. For example, an owner with extensive property holdings who is also engaged in another full-time occupation may not want to be bothered with detailed, time-consuming reports. But a retired person with only one or two income producing properties may want to be very involved in their management.

**Statement of Operations.** In many cases, the property manager’s report to the owner takes the form of a monthly statement of operations. A statement of operations typically includes the following sections: a summary of
operations, the rent roll, a statement of disbursements, and a narrative report of operations.

The **summary of operations** is a brief description of the property’s income and expenses that makes it easier for the owner to evaluate the property’s monthly financial performance. The summary is supported by the accompanying information in the rest of the statement of operations.

The **rent roll** is a report on rent collection. Both occupied and vacant units are listed in the rent roll, as well as the total of rental income earned, both collected and uncollected. (The combined rental values of the leased and the vacant space should equal the total rental value of the building.) The rent roll breaks down rental figures into the previous balance, current rent, total amount received, and balance due.

The information in the rent roll is obtained from the individual ledger sheets kept on each tenant and rental space. A ledger sheet typically shows the tenant’s name, unit, phone number, regular rent, other recurring charges, security deposit information, move-in date, lease term, payments made, and balances owed.

The **statement of disbursements** lists all of the expenses paid during the pertinent time period. A written order should be prepared for every purchase and payment so that an accurate account can be made of all expenditures and the purpose of each one. Disbursements are usually classified according to type, which makes analysis easier. For example, all maintenance expenses should be listed together, and so should all tax and insurance expenses, all administrative expenses, and so on.

In addition to the numerical accounts given to the owner, it is often helpful to include a **narrative report of operations** in the statement of operations. This is simply a letter explaining the information set forth in the other sections of the statement. The narrative report adds a personal touch, and it is especially important if the income was lower or the expenses were higher than expected. If there is a deviation from the normal cash flow, the owner will want a clear explanation. If the reason for a drop in cash flow is
not explained, the owner may doubt the competence or integrity of the property manager.

**Keeping in Touch.** In addition to sending various reports and statements to the owner, the manager should contact the owner in person from time to time. A telephone call or an appointment to explain a particular proposal or problem or to ask a question is much more effective than a letter. A formal meeting is a good idea if the monthly report is especially unusual.

**Maintenance**

In addition to leasing, tenant relations, recordkeeping, and reporting to the owner, a property manager is responsible for the supervision of property maintenance. There are four basic categories of maintenance activities:

1. **Preventive maintenance:** This preserves the physical integrity of the premises and reduces corrective maintenance costs. (Cleaning the gutters is an example of preventive maintenance.)
2. **Corrective maintenance:** Actual repairs that keep equipment, utilities, and amenities functioning in a proper manner. (Fixing a leaking faucet is an example of corrective maintenance.)
3. **Housekeeping:** Cleaning the common areas and grounds on a regular basis (for example, vacuuming hallways and cleaning elevators).
4. **New construction:** This includes tenant alterations made at the beginning of the tenancy and when the lease is renewed, as well as cosmetic changes designed to make the building more attractive (for example, remodeling the lobby).

When managing commercial or industrial property, a property manager is often required to alter the interior of the building to meet the needs of a new tenant. These alterations can range from a simple repainting job to completely redesigning or rebuilding the space. (If the property is new construction, the interior is often left incomplete so that it can be built to fit the needs of the individual tenants.) Property managers dealing with remodeling or new construction must be aware of federal laws requiring
public accommodations to be accessible to the disabled. (See the discussion of the Americans with Disabilities Act in Chapter 16.)

Property managers are not required to know how to fix the building’s plumbing or electrical wiring themselves. Most maintenance activities are handled by building maintenance employees or by outside maintenance services. However, a property manager must be able to recognize the maintenance needs of the property and see that they are fulfilled.

The property manager should direct the activities of the maintenance staff or independent contractors with a schedule of inspection and maintenance. First, the manager should inventory the building’s equipment and physical elements (plumbing, furnace, roof, walls, etc.). Then a schedule of regular inspections, cleaning, and repairs should be set. For
instance, walls and roofs should be scheduled for periodic inspection, painting, and repairs. Elevators should be serviced on a regular basis.

The property manager should keep accurate and up-to-date records of when the various elements were inspected, serviced, replaced, or repaired. These routine inspections and maintenance activities will help preserve the capital value of the building and prevent major repair expenses.

Risk Management

One of a property manager’s most important responsibilities is risk management. If proper precautionary measures are not taken, an unexpected event can cause tremendous financial losses due to property damage, lost rents, or even lawsuits. A property manager must evaluate the various options available for preventing or mitigating these risks.

A common way to protect against financial loss is to purchase insurance. Many property managers take out public liability insurance to cover the risks assumed when members of the public enter the property. Casualty, fire, and hazard insurance are also commonly used to protect against unforeseen events such as theft, fire, or flooding. (We discuss property insurance in more detail in Chapter 18.)

It’s important to note that the physical safety of tenants has become an increasingly important issue for owners and property managers. If a tenant is injured by an intruder or fellow tenant, courts are now more likely to hold the owner and manager responsible. As a result, it is common nowadays for leases to include provisions making criminal activity a ground for eviction.

Environmental Issues

Property managers are often called upon to respond to environmental problems such as hazardous waste or air quality. Federal, state, and local laws determine the environmental responsibilities of property managers. Arranging for proper disposal of tenant waste is only one of many things a property manager may be required to provide. Although not always required,
providing recycling facilities can make a property more appealing to prospective tenants.

**Landlord/Tenant Law**

A property manager needs to understand the rules that govern the relationship between landlord and tenant. The landlord-tenant relationship is defined both by law and by the terms of the lease contract itself.

As we discussed in Chapter 8, a lease is a contract between a property owner and a tenant, and must meet all of the requirements for a valid contract. In many cases, the management agreement authorizes the property manager to sign leases as the landlord's agent. Without such a specific authorization, the property manager's signature will not create a valid lease.

It is not generally necessary for a lease to be recorded, although some states may permit a landlord to record a lease in the county where the property is located. Some states require a lease with a term of three years or more to be recorded.

**Lease Provisions**

Many of the following issues are commonly addressed by the provisions of a lease. In some circumstances, the legal rules established by state statute may apply only when the lease doesn’t address a particular issue; other legal provisions may override any contradictory clauses in the lease. These legal rules vary from state to state.

**Possession.** A tenant is entitled to quiet enjoyment of the leased property. The landlord promises (actually or implicitly) that the tenant’s possession of the property will not be disturbed, either by the landlord or by a third party with a lawful claim to the property. The tenant is guaranteed exclusive possession and quiet enjoyment of his leasehold estate. The landlord is required, in most states, to take all necessary measures to remove a holdover tenant or adverse claimant. Some states require the tenant to
file a lawsuit to obtain actual possession of the property.

**Payment of Rent.** The consideration that the tenant gives the landlord for the lease is the promise to pay rent. Most leases spell out when the rent is to be paid, and they usually require payment at the beginning of the rental period. If a lease does not specify when the rent is to be paid, however, it is not due until the end of the rental period.

**Lease Term.** A lease should also contain a statement of the lease term, including the beginning and ending dates. A lease for an indefinite period of time may be held invalid by a court. In some states, a lease term of 100 years or more is prohibited. If an option for renewal is given to the tenant, additional language should be included in the lease specifying when and how the option may be exercised.

**Use of Premises.** Not surprisingly, the law restricts a tenant’s use of the leased property to legal uses. Many leases place additional restrictions on the use of the property; For example, a commercial lease might have a provision restricting the rented space to retail use. The restricting language must be clear. At a minimum, the lease should state that the premises are to be used only for the specified purpose and for no other. If there is no limitation in the lease, or if the language is not clearly restrictive, the tenant is generally permitted to use the premises for any legal purpose.

**Security Deposit.** Most property managers require a security deposit from the tenant when the tenant signs the lease, especially in residential tenancies. The deposit gives the landlord some protection should the tenant damage the property or fail to pay the rent.

Many states place various restrictions on security deposits. For instance, the size of a residential damage deposit may be limited to the amount of one month’s rent. Security deposits are often required to be placed in a trust account. Furthermore, some states do not allow the security deposit to be used for both property damage and nonpayment of rent.
Entry and Inspection. A lease typically provides for inspection of the leased premises by the landlord during the lease term, under specified conditions. As a general rule, a residential tenant may not unreasonably refuse the landlord’s legitimate requests to enter the unit to inspect it, perform repairs, provide other agreed-upon services, or show the unit to prospective buyers or tenants. The landlord usually must provide the tenant notice before entering the unit.

Maintenance. In most states, all residential leases carry the landlord’s implied guarantee that the premises meet all building and housing code regulations that affect health and safety. If the premises do not meet these criteria, then the tenant must notify the landlord of the defective condition and the landlord must correct it within a certain time period prescribed by statute.

A tenant must return the premises to the landlord in the same condition in which they were received, with allowances for normal wear and tear. The landlord is usually responsible for making necessary repairs to common areas, such as the stairs, hallways, or elevators.

Rent Control

Ordinances called rent controls set maximum limits on the amount of rent that a landlord may charge. New York and San Francisco are two cities that have some form of rent control ordinances. Rent controls are intended to make property available at reasonable rates when there is a housing shortage.

Many economists believe that rent controls are not effective in accomplishing their primary goal of providing affordable housing. They argue that rents become high because demand for housing exceeds supply. In order for rents to come down, demand and supply must be brought into balance, either by reducing demand or by increasing supply. Rent controls usually have little positive effect toward either of these aims. Artificially low
rents may in fact increase demand. In addition, the resulting low yields to property owners may discourage the construction of new housing.

Types of Leases

Property managers must be familiar with the various types of leases. There are six major types: fixed leases, graduated leases, index leases, net leases, percentage leases, and ground leases.

**Fixed Lease.** Sometimes called a flat, straight, or gross lease, a fixed lease provides for a fixed rental amount. The tenant is obligated to pay a fixed sum of money and the landlord is obligated to pay all maintenance costs, taxes, and insurance. Also called a gross lease, this type of lease is most commonly found in residential apartment rentals.

**Graduated Lease.** A graduated lease is similar to a fixed lease, but it provides for periodic increases in the rent, usually set at specific future dates. These increases are made possible by the inclusion of an escalation clause. This type of lease is also called a step-up lease.

**Index Lease.** Landlords often use index leases for long-term tenancies. This type of lease is often based on the Consumer Price Index or some other measure of inflation. When there is an increase in the index, the rents increase.

**Net Lease.** A net lease requires the tenant to pay the landlord a fixed rent, plus some or all of the operating expenses. Commercial leases are often net leases. A triple net lease (or net-net-net lease) requires the tenant to pay all of the operating expenses in addition to rent. These expenses might include property taxes and the cost of insurance, utilities, and maintenance.

**Percentage Lease.** Many retail businesses have percentage leases, especially in shopping centers. The rent is based on a percentage of the gross or net income from the tenant’s business. Typically, the lease provides for a minimum rent plus a percentage of the tenant’s business income above the stated minimum.
**Ground Lease.** In a ground lease, the landowner leases vacant land to a tenant who wants to construct a building on that land. In this manner, ownership of the improvements is separated from ownership of the land itself. Ground leases are common in metropolitan areas; they are usually long-term, in order to make the construction of the building worth the tenant’s while. (Rockwell, 454-476)

**Cited Material:**