

What You Should Know About Property Management

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Now that you have made an offer to acquire a commercial property and are waiting to close escrow, you may want to start looking for a property manager to professionally manage the property. Your real estate investment advisor should present you with 2 or 3 local companies, each with its own proposal. Your job is to decide which company you will hire. The property manager will be the main point of contact between you, as the landlord, and the tenants. Her main job is to:

- Receive and collect the rents and other payments from your tenants. This is typically simple until a tenant does not send the rent check. A good property manager will somehow get the tenant to pay the rent while a lousy one will throw a monkey on your back!
- Hire, pay, and supervise personnel to maintain, repair and operate the property, e.g. trash removal, window cleaning, and landscaping. Otherwise, the property loses its appeal, and customers may not patronize your tenants' businesses. The tenants then may not renew their lease. As a consequence, you may not realize the expected cash flow.
- Lease any vacant space.
- Keep an accurate record of income and expenses, and provide you with a monthly report.

A good property manager is critical in keeping your property fully occupied at the highest market rent, the tenants happy and in turn helps you achieve your investment objectives. Before choosing a property management company, you may want to:

- Interview the company with focus on how the company resolves problems.
- Talk to the person who will manage the property day to day as this may be a different person from the one who signs the property management contract. You want someone with strong interpersonal skills to effectively deal with tenants.

The property managing company normally wants a contract for at least one year. The contract should spell out the duties of the property manager, compensation, and what will require the landlord's approval.

Agent's Compensation: you will have to pay someone to manage and lease the property. You may have one company to manage the property and a different company to lease the property. However, it's best to work with one company that handles both managing and leasing to save time and money.

- Management fee: the fee varies between 3-6% of the base monthly rent for a retail center, depending on the amount of work needed to manage the property. For example, it takes much less time to manage a \$2M retail center with just a single tenant than a \$2M retail strip with 12 tenants. So, for the center with 12 tenants, you may have to pay a higher percentage to motivate the property manager. You should negotiate the fee as a percentage of the base rent instead of the gross rent. Base rent does not include NNN charges. Ideally, you want a lease in which the tenants pay for their share of property management fee.
- Leasing fee: this fee compensates the property manager to lease any vacant space. In a typical lease contract, the leasing company wants 4-7% of the gross rent over the life of the lease. It also wants the leasing fee to be paid when the new tenant moves in. In addition, the leasing company wants around 2% of gross rent when the lease is renewed. The tenant may also ask for Tenant Improvement (TI) credit, typically between \$10-20 per square foot to pay for construction expenses. So if a new tenant with a 10-year lease goes under after one year then you may lose money. As the landlord you should:
 - Approve a long term lease (10 years or longer) only when the tenant's financial strength is solid. Otherwise, it may be better to reduce the lease to 3-5 years.
 - Make sure the new lease has a provision for some kind of rent escalation, preferably based on Consumer Price Index (CPI), i.e. inflation which is 3-4% a year instead of lower fixed 1-2% annual increase.
 - Consider TI request from the tenant as one of the factors to approve a lease. The TI credit depends on whether you need the tenant more or the tenant needs you more.
 - Negotiate for a flat rate renewal fee, e.g. \$500 instead of paying a percentage of the rent for the life of the lease. The negotiation is easier with one company that handles both leasing and management.
 - Negotiate to pay the leasing agent a lower percentage, e.g. 4% when no outside leasing broker is involved.

You can see that it's very important to minimize tenants' turnover rate as it has a direct impact on the cash flow of your commercial property. A good property manager will help you achieve this goal.

Monthly Report: each month the property manager should send you a report on income received, expenses incurred, and property status. You should:

- Review the report to see if the numbers make sense.
- Request a report showing both rent and CAM fees received.
- Request a separate bank account for your property and have a monthly bank statement sent to you. Without this, the property manager will deposit and commingle all the rents from all properties that she manages into her company's bank account.

If you instruct the property manager to send you the excess cash flow then you will also get a check.

Landlord's Approval: the management contract should specify the dollar limit for exceptional maintenance expense above which would require your approval. This amount varies from landlord to landlord as well as the type of property. However, it's typically somewhere between \$500 to \$2,000 dollars.

Communication with property manager: in the first few months, you and the new property manager should communicate often to make sure things go smoothly. You should give instructions in writing, e.g. email, to your property manager and keep records of all your correspondence. If the property manager does not do what you instructed, you may refer to your records and minimize disputes.

If you want to work hard for your money, you may want to manage your own property. However, if you want to work smart, your partner should be a good property manager.

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