RISKS AND BEST PRACTICES FOR REAL ESTATE AGENTS INVOLVED IN PROPERTY MANAGEMENT

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As real estate sales can be the source of a highly unpredictable income stream, especially in light of the current real estate market, many real estate agents are turning to property management as a way to secure a dependable source of income.

The main functions of a property manager managing an occupied asset include: qualifying and finding tenants; collecting rents; ensuring that maintenance and upkeep is performed; and ensuring that non-paying tenants are removed through the eviction process or by other means. While managing a property that is vacant, the main functions of a property manager include: ensuring that there has been no vandalism, broken windows, broken pipes, looting, or other damage; preparing the property for rent; and accounting for the money being expended to maintain the asset. Notwithstanding the foregoing, property management involves much more than dealing with rents and collecting bills. A hallmark of property management is dealing with personalities and problems. More importantly, the laws governing real estate brokerage and property management are not similar. It is easy to make mistakes if you do not have someone experienced running the helm of your property management enterprise.

A real estate agent acting as a property manager must be vigilant, as more complaints are filed against property managers than real estate agents specializing in other areas. This is primarily because property managers work with a number of different people and entities in the course of managing an asset, including but not limited owners, tenants, banks, lenders, auditors, service personnel, landscapers, painters, plumbers, electricians, and anyone else whose service is essential to keep the asset in rentable condition. It is of the utmost importance for a real estate agent acting as a property manager to keep detailed records and have errors and omissions insurance in the event that the worst case scenario arises.

**Fiduciary Duties of a Property Manager**

While a property manager interacts with many different individuals and entities in the course of his or her employment, a property manager works for the owner of the property and owes a fiduciary duty to the owner of the property. In states were a real estate agent is regarded as a fiduciary under the law, a real estate agent acting as a property manager has an obligation of diligent and faithful service to the owner of the property, the same as that of a trustee. Civil Code § 2322(c). In these states, a real estate agent acting as a property manager is required to disclose to the owner all information relevant to the subject matter of the agency. For instance, a real estate agent or broker can be liable for concealing or failing to disclose the receipt of offers on a property.

A real estate agent acting as a property manager must act with the highest good faith to the owner of the property being managed, and disclose all information that may affect the owners affairs or decisions. Miller & Star, CA Real Estate 3d, §3:25. A real estate agent acting as a
property manager is required to disgorge any secret profits derived from the agency, cannot act adversely towards the owner, and must act for the sole benefit of the owner in matters connected with the agency. As a result of the foregoing, a real estate agent acting as a property manager must disclose to the owner all rental offers received, and should document the same. Let the property owner select the tenant for the property. This will make it difficult for the owner to hold you responsible if the renter defaults on the rent or causes damage to the physical condition of the property. If a tenant falls behind on the rent, immediately disclose this information to the property owner. Let the property owner make the decision as to the best way to remedy the situation. If you receive information that a tenant has caused damage to a property you are managing, even if the tenant is your best friend, parent or sibling, as property manager, you must immediately bring this to the attention of the owner. As a property manager must always act for the sole benefit of the property owner, your response when a renter falls behind on rent or causes damage to a property must always benefit the owner, even if this means evicting your best friend, parent or sibling.

Remember, it is the duty of a real estate agent, when acting as a property manager, to obey the instructions of the property owner. Miller & Star, CA Real Estate 3d, §3:25. The extent of the duties owed to the owner do not depend on the sophistication of the principle/owner.

Handling Money
In California and other states, the most common violation of broker licensing laws occur in the administration and handling of trust funds. Rental funds collected by a property manager must be placed in a trust account. The proper handling of property management trust accounts is complicated by the fact that these fiduciary accounts are regulated by state law. Make sure to review the applicable laws governing the handling of trust funds in your state before administering trust accounts.

Trust Accounts
A trust account is a fiduciary account established to hold funds that belong to another party. The real estate licensing authorities generally describe trust funds as money or other things of value that are received by a broker or salesperson on behalf of a principal or any other person, and which are held for the benefit of others in the performance of acts for which a real estate license is required. The laws governing trust funds usually apply to all licensed real estate professionals and are administered by the state licensing agency.

In most states, all funds belonging to building owners, in addition to security deposits received from tenants, must be placed in a trust account. Generally speaking, any funds that a real estate agent or broker collects that have to do with a property must be deposited into a trust account. The funds derived from any income producing equipment or appliances servicing a property, including but not limited to laundry or vending machines, must also be deposited into a trust account and accounted for as if they are owner funds.

Commingling of Funds is Prohibited
The most serious accounting violation when administering a trust account is the commingling of owner and broker/manager funds. Owner funds contained in a trust account cannot be commingled with any other funds. Commingling is strictly prohibited by law and is grounds for revocation or suspension of the license of a real estate professional.
Commingling occurs when:

1. Personal or company funds are deposited into a trust account. This is typically a violation of the law even if separate records are kept.
2. Trust funds are deposited into the licensee’s general or personal bank account rather than into the trust account. This is also grounds for suspension or revocation of a realtor’s license.
3. Commissions, fees, or other income earned by the real estate agent or broker and collectible from the trust account are left in the trust account for more than 25 days from the date they were earned. This time frame can vary from state to state. Check with the laws in your state to determine the length of time commissions, fees and other income earned by the real estate agent or broker and collectible from the trust account can be left in the trust account.

A common example of commingling is depositing rents and security deposits on broker-owned properties into the trust account. As these funds relate to the broker’s properties, they are not trust funds and therefore, may not be deposited into the trust account. Likewise, a broker may not make mortgage payments and other payments on broker-owned properties from a trust account even if the broker reimburses the account for such payments. Conducting personal business through a trust account is strictly prohibited and is a violation of real estate law.

Another common and somewhat surprising example of commingling occurs when the property management fee is not withdrawn in a timely fashion. For example, assume that by contract your management fee for the month of February is to be paid as of March 1, 2012. In some states, if you do not remove those funds within 25 days of when they are earned, you are in violation of the rule against commingling funds. One way to avoid this is to have a computer program in place that automatically and internally transfers the management fee from the owner's column to the broker's column when the rent is paid. Again, this 25 day time frame can vary from state to state. Check with the laws governing your state to determine the length of time you have to withdraw the property management fee from the trust account.

**Depositing of Trust Funds**

Another problematic aspect of administering trust accounts is the relatively short time frame one has to deposit funds into a trust account. In most states, all funds received in connection with purchase or lease of real property must be deposited in the trust account no later than the next business day.

In order to ensure professionals are managing trust accounts in compliance with state laws, some states regularly audit trust accounts, while other states conduct audits only when they receive a complaint. As there are a multitude of land mines that exist in connection with the administration of trust accounts, it is critical for real estate agents acting as property managers to be aware of the applicable accounting and trust guidelines in your state and follow them with care. The failure to follow trust administration guidelines could lead to the loss of your professional license.
Repair and Maintenance Issues
As a property manager, it is a good practice to inspect the properties you manage on a regular basis, even absent a problematic tenant. Once a tenant moves into a house, assuming they pay the rent on time and you do not receive any complaints from the neighbors, there is a good chance you will not step foot inside the house during the duration of the tenancy. This can lead to complications, as some tenants may not inform you if there is a problem with the house. The following example is illustrative. A tenant moves into a house and observes evidence of a seemingly minor roof leak at the beginning of his or her tenancy. The tenant fails to report the leak and water staining results during the year the tenant occupies the property. Upon moving out of the property, the property manager inspects the unit, observes evidence of water damage and hires the appropriate professionals to inspect the leak and resultant water damage. The licensed professionals determine that the roof is at the end of its useful life, needs to be replaced, and the leaking has caused structural damage to the wood framing members of the house, in addition to widespread mold. The remediation of the mold and water damage at this point in time is going to be much more time consuming and costly, as these conditions were left idle and to compound throughout the year.

This situation can be avoided by setting up inspections of the properties you manage once every few months, or once a year, depending on the age of the property and whether the tenant contacts you to report maintenance and repair issues as they arise.

Distressed and REO Properties
In property management, someone else’s problems often present an opportunity for you. Opportunities are strongest with lenders who are able to hold onto assets for a year or so and stabilize them prior to sale. To prevent further asset deterioration, banks want property managers who can obtain control of the property quickly and take rapid steps to reduce risks and add value. That means being on call twenty-four hours a day, seven days a week, and often times having a team of lawyers and construction specialists in place. Managing distressed property can often times not be profitable, as it can be very management intensive. Many real estate agents accept distressed property assignments from lenders as a way to cultivate relationships with the lender and the potential buyer, with the hope of getting the management contract from the buyer and offering ongoing property management services. One way to ensure that you profit from distressed property management as a real estate professional is to include a provision in the property management contract that provides you with the option to list and sell the property when the owner is ready. Additionally, charging a small fee for the management of an REO creates a good pipeline for sales. If you are looking to make a profit from managing distressed properties, build in a minimum management fee so that you will earn money even if the property is not occupied. Success with the management of distressed properties also hinges on selecting properties that have solvable problems. Some properties are so poorly designed and located that they are never going to lease at rents to support the loan.

Conclusion
While property management is a means to supplement your income stream while riding out the current ebbs and flows of the real estate market, being aware of the risks and best practices in the industry will lessen the chances you will be on the responding side of a complaint.