

Chapter 1

Property Management 101

In This Chapter

- ▶ Looking at the pros and cons of property management
 - ▶ Exploring the different types of real estate
 - ▶ Surveying the steps involved in renting your property
 - ▶ Walking through the day-to-day details of property management
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The key to long-term success and wealth-building through real estate ownership lies in the foundation you acquire as a hands-on property manager. For instance, some people start out managing rental properties owned by someone else and gain a great deal of experience that they can use for their portfolio.

There are many positive reasons for becoming a rental property owner or manager, and just as many ways of doing so. Perhaps you've saved up the down payment to purchase your first small rental unit and hope to see your investment grow over the years as a nice retirement nest egg or a supplement to your current income. Maybe you want to invest in a medium-sized apartment building and build some equity as well as rental income to supplement or replace your current income. Perhaps you've inherited Aunt Gertrude's run-down cottage and need to find a good tenant who'll care for it and pay the rent on time. Maybe you've recently closed on your new primary residence, only to find that selling your existing home isn't as easy as the real estate agent promised. Or perhaps you've had to move across the country to find a suitable job but want to return to your home in the future.

Whether you plan to become a full- or part-time property manager, you need to know what you're doing — legally and financially. This chapter serves as a jumping-off point into the rental property world. Here you can find useful info, tips, and checklists suitable for novice or seasoned rental property managers. So get ready for some practical advice from the tenant trenches to help you handle situations when they arise!

Understanding What Property Management Really Is

Property managers provide consumers with a product known as *shelter*. In other words, as a property manager, you supply tenants with a place to live in exchange for the payment of rent. Although property management doesn't seem that complex, you can avoid the many mistakes unprepared property managers make by knowing what you're getting into.

The following sections give you a quick overview of the pros and cons of property management. Chapter 2 provides more in-depth analysis of these advantages and disadvantages to help you determine whether renting your property is the right choice for you.

Considering the benefits

Property management can be a rewarding and fun venture. I can't imagine my life without some aspect of property management in it (why else would I have written this book, right?). Following are some of the reasons why I get such a kick out of this business:

- ✔ **Experience with real estate investment:** As you manage rental property, you have the opportunity to observe and begin to understand investing cycles, which is an essential skill for becoming a successful real estate investor. Of course, some real estate investors succeed without ever being hands-on property managers because they hire others to handle the task for them. However, I believe rental property owners should gain that real estate investment expertise by actively working as property managers for several years, either for themselves or others.
- ✔ **Interaction with different people:** If you're a people person, you'll find that property management is a great opportunity to meet all types of people. Not everyone you encounter is someone you want to make your close friend, but you'll certainly have the chance to work with a smorgasbord of personalities.
- ✔ **Skill development:** Property management requires diverse skills because you must handle so many different tasks (such as marketing, advertising, leasing, screening, and maintenance). But it also allows you to grow those skills beyond the basics through patience and passion. For example, you may begin by advertising your rental unit in a basic way and move to analyzing an entire ad campaign. Pay attention to how unrelated products are presented for sale and apply those concepts to rental housing. Most of the best marketing ideas are already out there, and you just need to adapt them to your rental property.

- ✔ **Variety:** Personally, I enjoy the variety of tasks and challenges found in property management. Sure, some aspects of it are repetitious. Rent is due every month, and all properties require ongoing care and maintenance. But for the most part, every day in property management is something new.

Confronting the icky parts

You can't expect all aspects of property management to be fun. Just like your primary job, some days run smoothly, and others are filled with problems. Here are a few of the bad aspects of the property manager gig:

- ✔ **Difficult tenants:** Despite the great people you meet, property management has its fill of difficult and challenging personalities, including people who're downright mean and unpleasant. You have to be prepared for adversarial and confrontational relationships with others. Collecting the rent from a delinquent tenant, listening to questionable excuses, or demanding a contractor come back and do the job properly requires patience, persistence, and a fair but firm approach.
- ✔ **Long hours:** Because you're dealing with housing, you don't know when you're going to be needed. It may be 3 p.m. or 3 a.m. Like me, you can expect to be constantly on call — even when you're on vacation, at the movies, or in the middle of a family holiday dinner — to deal with issues that only the rental owner or property manager can handle. Fortunately, you can minimize these inconveniences by planning carefully and hiring competent and reliable employees and vendors who can prevent many unexpected emergencies through good management and maintenance. However, owning and managing rental property remains a 24/7, year-round commitment.
- ✔ **Need for emergency capital:** One of my favorite sayings and goals in life is “No surprises,” but owning rental properties can lead to situations in which unanticipated expenses arise at any time. Tenants suddenly stop paying rent at the same time the roof leaks and the water heater goes out in the middle of the night! Having a nice nest egg, a rainy-day fund, or at least a decent unsecured credit line at reasonable rates can be very helpful, as most rental property owners experience a squeeze on their cash flow at times.
- ✔ **Potential liability:** After more than 30 years in property management, my opinion is that most tenants are good people just looking for a decent, quiet place to call home. But some “professional tenants” look for any mistakes you make or even set traps for you to fall into that can lead to claims for free rent or even litigation. You need to stay on top of all the legal requirements for landlords in your area and make sure you always comply with all laws and disclosures. If you're not willing or able to keep up with ever-changing legal requirements and health and safety issues, or if you're sloppy with your record-keeping, you may learn some expensive lessons!



Renters drive rental property management

The Census Bureau reports that more than one-third of the U.S. population, or 94 million people, are renters occupying nearly 39 million rental units, including more than 13 million single-family home rental properties. The number of renters has increased in the last few years with the economic challenges in most areas of the country. Also, the limited availability of credit has made it more difficult to become a homeowner, and the overall percentage of homeownership has fallen from a high of 69 percent in 2006 down to 65 percent in late 2012.

Individual property owners dominate the rental housing industry. According to the National

Multi Housing Council, individuals own nearly 85 percent of the small rental properties with 2 to 4 units and nearly 60 percent of the residential income properties with 5 to 49 units. In comparison, one of the most popular ways for individuals to invest in real estate is through real estate investment trusts (REITs), which have exploded in the market with the acquisition of billions of dollars of high-profile rental real estate assets. Yet, in spite of the significant publicity they've received in the real estate media, REITs actually own less than 10 percent of all residential rental housing units in the United States.

The good news is that these negatives can be found in many other careers or professions that don't offer the benefits and satisfaction you can get from property management. So in my opinion, the pros outweigh the cons.

Examining the Types of Real Estate Available

Before you run out and purchase a rental property, you need to have a good idea of the different types you can own. Most real estate investors specialize in properties with specific uses. Investment properties fall into classifications such as residential, commercial, industrial, and retail.

For the purpose of this book, I focus only on residential real estate because the majority of rental real estate is housing, and the basic concepts are easy to understand and master. (After you master the basic concepts of residential real estate, you may want to consider other types of property management.) The best practices I present throughout this book are applicable for these types of residential rental properties:

- ✔ **Single-family houses and condominiums or townhomes:** Most real estate investors start with a rental home, condo, or townhome because these properties are generally the easiest ones to gain experience on. They may be located in a common interest development (CID) or community association where all the common areas are the association's responsibility.
- ✔ **Duplexes, triplexes, and four-plexes or subdivided houses:** This category includes properties with two to four units. Often these properties are the first choice for real estate investors who plan to live in one of the units or want to take the next step up from investing in a single-family rental home or condo. These properties qualify for favorable financing terms, so they're perfect for the new investor or an investor buying in higher-priced urban markets.
- ✔ **Medium-sized multi-family apartment buildings:** These buildings usually have between 5 and 30 units and are best run with on-site management and regularly scheduled maintenance and contractor visits.
- ✔ **Large, multi-family apartment buildings:** These properties are larger buildings that can have 30 or more rental units in a single location, with an on-site manager or maintenance staff. Owning one of these properties is the goal for many real estate investors who look forward to being able to hire a professional property manager and just check their bank account for their regular cash distributions. (I reveal what to look for in a good professional property manager in Chapter 3.)

No matter what type of residential real estate you're involved with, you need to understand the basics of property management. You must market or staff a property differently depending on its size and location, but many of the fundamentals are the same, regardless.

Over the course of your tenure as a property manager, you'll probably manage several different types of properties. That's just one of the challenging yet fulfilling aspects of the job. For example, you may start out managing single-family rental homes or condos and then see your investments or career progress to larger rental properties. Sometimes people in the rental housing business start out as on-site employees for large rental properties, learn the ropes, and later apply that knowledge to become the Donald Trump of rental houses in their area.

Owning and managing all types of rental property can be lucrative, and I suggest you jump in where you have your first opportunity, because no rules mandate your starting position.

Factors that influence real estate as an investment

Almost everyone has heard the adage that the top three keys to success in real estate are location, location, location. This adage is more than just a cliché. Unlike a stock investment, you can't easily liquidate real estate and reinvest in another opportunity in a different geographic area. Real estate success is closely correlated to a property's location.

Real estate is also a very cyclical business that's subject to the Economics 101 concepts of supply and demand. During economic business expansions, the demand for real estate is strong, enabling owners to raise rents. With the higher rents, real estate developers can build new properties, which causes the supply of real estate to catch up with the demand and forces rent increases to slow or disappear. When the business economy begins to slow, the demand declines, and once again you have an abundance of rental real estate. This cycle typically repeats every seven to ten years but can go longer.

One of the best reasons for investing in residential real estate (versus commercial or retail properties) is that it tends to be the most stable sector of the real estate market, a fact that was proven again in the economic downturn that began in the mid-2000s. Virtually all types of

real estate income properties saw significant decreases in value during that downturn, but residential real estate fared better than any other category and rebounded first when the market began to improve.

Thanks to very generous tax laws, for many years (prior to the major income tax law changes in 1986) real estate investors really didn't have to worry about the cash flow generated from their properties. An owner's ability to generate tax losses that could be offset against earned income, plus other creative tax strategies, outweighed the common-sense goal of generating more income than expense. Positive cash flow was just an added benefit.

The bottom line: After you purchase your property, you can't effectively control or change its location. Nor can you really influence the overall business economy or real estate cycles.

Seem perplexing? Many so-called "investing gurus" try to sell you their DVDs, but if you're looking for honest advice on the proper way to find, evaluate, and invest in residential real estate, I suggest you read *Real Estate Investing For Dummies*, 2nd Edition (Wiley), which I coauthored with Eric Tyson.

Renting Your Property

One of the first and most important lessons I learned when I started in property management more than 30 years ago is that vacant real estate isn't a very good investment. You need to fill those vacancies and keep them filled with tenants who pay on time. Just try looking in the mirror and telling yourself that all the rent came in last month. I bet you can't do it without smiling!

Of course, renting your property and retaining your tenants doesn't just magically happen; it requires a plan and a lot of work. But you want to work smart and not just hard. In the following sections, I cover some of the best practices for preparing your rental units, setting your rents, attracting qualified prospects, and closing the sale.

Chapter 4 expands on where it all begins: the acquisition of the rental property. Part II then helps you position your new rental property within the rental market and discover how to find good tenants.

Preparing the property

Before you can rent your property, you have to make sure it's ready for a tenant to move in. However, you can't simply put a For Rent sign up and expect to rent to the first caller. You need to spend some time properly preparing the property. And by "some time," I mean a lot.

Relax! Tear up that application to those cable shows that completely renovate your fixer-upper for free, because you *can* prepare your property yourself. Just remember to focus on the inside as well as the outside. Chapter 5 shows you the best way to determine what to upgrade and renovate to meet the needs of your target market of prospective renters. I also explain how to ensure that your property's *curb appeal*, or its exterior appearance, makes your potential new tenants want to see the inside of it and not keep driving by to the next property on their list.



During this stage, you really get to test your decorating skills on a budget because you don't want to over-improve the property. But if you're too tight and try to get by with anything less than your best effort, be ready for the majority of those individuals showing interest in your rental unit to be the least-qualified prospective tenants. The moral of the story? Don't be cheap, but do be practical!



To get the great tenants, you need to guarantee your rental property compares favorably to other properties in your area and makes that important positive first impression. This impression starts on the exterior, with a neat and well-maintained appearance, and continues with a clean and inviting interior, with the features and amenities expected by prospective tenants in your area.

Properly preparing the unit also often requires the use of outside vendors or contractors. What you don't contract out — tasks such as basic cleaning, maintenance, and painting — you need to do yourself. You also need to know how to perform a careful inspection to make sure the unit is ready to show. I give you details about how to accomplish all these tasks in Chapter 5.

Knowing how much to charge

Understanding what you can charge your tenants is far from arbitrary. Setting the rent in particular can be tricky — especially if you've just spent hours investing your time and sweat into renovating and scouring your rental unit to make it sparkle.

In such cases, you may overestimate the market value of your unit because you have so much personally invested. But your prospects aren't likely to be impressed that you laid the tile. Instead, they'll quickly point out that the carpet color doesn't match their furniture, but if you lower the rent \$300 per month, they'll consider taking the unit off your hands, almost as if they're doing you a favor. You may be able to structure some mutually beneficial rental concessions, but don't be a pushover.

Many rental property owners are simply too nice. Maybe you're someone who has trouble bargaining and holding out for the top fair-value dollar, kind of like my mother-in-law, a sweet but overly generous woman — especially when it came to yard sales. My wife and I are glad no one ever offered Rita 50 cents for our car!

In addition to setting the rent, you need to make the following decisions before a tenant moves in:



- ✓ **The amount of the security deposit:** Setting security deposits is a function of not only market conditions but also limitations on the amount you can charge and whether that amount's fully refundable. These restrictions are set by your state laws. Determining whether you want to pay your tenants interest on the deposits you hold is also subject to law, but certain advantages can warrant doing so even where not required (especially for long-term tenants).

The best way to decide on all the details of the security deposit is to conduct market surveys to see what others are doing. If everyone else has security deposits set at approximately half of a month's rent, requiring your new tenants to come up with a security deposit of two full months' rent upon move-in is difficult.

- ✓ **The type of rental contract:** Another important decision that has lasting consequences is deciding whether a lease or month-to-month rental agreement is best for your property. Such conclusions are often reached after conducting a market survey and understanding the pros and cons of each type of contract.

Check out Chapter 6 for more info on determining how much to charge, setting deposits, and figuring out what type of rental contract to use.

Capturing prospects' interest

A successful property manager needs to understand the role of marketing in creating demand and meeting the needs of local renters. Fortunately, your marketing and advertising possibilities have increased dramatically with the advent of the Internet and social media. You (or perhaps your teenage children) can develop a fantastic website with digital photos and floor plans. Just make sure you follow all the fair housing laws as you work to generate rental traffic.

In Chapter 7, I review the various electronic and nonelectronic options available for promoting your rental property and attracting prospective tenants.

Turning interest into property visits

The ways to attract potential tenants are endless, but the fundamentals of getting them to visit your property are centered around your ability to answer their questions on the phone. You need to understand how to qualify your prospects both for what you want in a stable, long-term resident and what they need to call your rental property their home for years.

Converting your e-mails or phone calls to actual property visits is the next essential step to creating maximum interest in your rental unit. Chapter 8 explains how to get prospective tenants to view your property.



The way in which you show your property to prospects is important. Avoid walking from room to room, stating the obvious. Instead, point out certain benefits of your unit's unique or special features. Just don't oversell the product and talk fast, like a late-night cable infomercial. Ultimately, the best technique for showing your property is letting the property itself make the right impression, as I explain in Chapter 9.

The best result you can expect to achieve at the property-viewing stage is convincing the prospect to complete your rental application and put down a holding deposit. What the prospect can expect from you at this time is the receipt of any mandatory disclosures.

Picking your tenants and signing the deal

Property management isn't exactly like an online dating game, but you do want to gather information (while following all fair housing laws to the letter) and select a tenant who meets or exceeds your minimum written rental qualification standards. Tenant selection is probably the one single step in the rental process that can make or break you as a property manager, and I devote a lot of detail to this important topic in Chapter 10.



With tenant selection, what seems to be a fairly straightforward process can actually be tricky because of the various limitations on the questions you can ask and the information you can request from interested applicants. Follow the same procedure for everyone to comply with fair housing laws, and determine how you're going to verify each prospect's rental application. Be sure to select tenants based on objective criteria and then properly communicate your decision to both approved tenants and unsuccessful applicants.

Getting Your Hands Dirty: Managing the Property

You never hear from your tenants, yet the check seems to come in the mail each month. Managing your rental unit seems easy — just like you pushed a button! But after a year of progressively busting out with pride at your exceptional property management skills, you decide to drive by the property . . . only to find that your retirement plans and financial nest egg are candidates for a remake of *Animal House!*

In the next sections, I present the practical, in-the-trenches part of property management that can help you get familiar with every day-to-day eventuality related to the operational side of property management and the life cycle of a tenancy.

Moving tenants in and out

Coordinating the move-in of a new tenant is one of your most pleasant tasks because this time is your best opportunity to ensure your tenant starts out on the right foot by explaining your rental rules and guidelines. Chapter 11 helps ensure your move-in process runs smoothly.

But all good things must come to an end. That end should start with you making sure that the move-out date is mutually agreed upon in writing and that the tenant understands your expectations, policies, and procedures through a tenant move-out information letter. I share more about how to make the move-out process as painless as possible for all involved in Chapter 15.

Collecting rent

You can greatly improve your chances of making the rent collection process a positive experience by emphasizing your rent collection policy when your tenant first moves in and by asking all the who, what, when, where, and how questions of rent payments.

But no matter how carefully you screen your tenants and how thoroughly you explain your rent collection policy, sometimes the inevitable happens and your tenant is unable to pay the full rent when it's due. What do you do? Start by issuing reasonable but firm policies when the tenant moves in and enforcing your grace period and late-period policies. Then, when your tenant doesn't pay the rent or doesn't live up to his responsibilities under the rental contract, you're prepared to take the appropriate legal action to regain possession of your property as quickly as possible. Chapter 12 provides more in-depth info to help you collect rent.

Keeping the good tenants



Turnover is your number one nemesis as a rental property owner. Although it's inevitable, your ability to renew your leases and provide incentives for your tenants to stay and pay can be significant in controlling your expenses and maximizing your rental income. That's why keeping your tenants, particularly your good tenants, is a smart move. After tenants have lived at your property for a while, you can quickly determine which ones are the better ones by asking yourself a few questions:

- ✓ Who pays the rent on time?
- ✓ Who quickly lets you know when the unit needs maintenance?
- ✓ Who takes care of the property, perhaps by cleaning up outside debris and planting flowers?



One of the best ways to ensure your good tenants stay with you is to develop a tenant-retention program where you offer them incentives. This action shows that you appreciate them. Chapter 13 offers more on the importance of developing a good landlord-tenant relationship from the perspective of your tenants. It also reveals your tenants' most important needs: good communication, timely maintenance, respect for their privacy, consistent policies, and a good value for their rental dollar.

Dealing with troublesome tenants

Despite your best tenant-screening efforts, you're going to make the wrong decision at some point and allow a problem tenant to move in or have a good tenant who turns sour. But you can lessen the number of these incidents by getting to know some of the problems you may encounter and how to deal with them early on:

- ✓ **Late or missed rent payments:** The timely payment of rent is the lifeblood of real estate investing because you can't pay your mortgage or expenses without it. A written rent collection policy is a valuable tool to minimize these problems.
- ✓ **Loud tenants:** It only takes one boisterous tenant to disrupt the tranquility of the whole neighborhood and destroy your tenants' right to "quiet enjoyment." Developing and implementing rental policies and rules can avoid your problem tenant chasing the good tenants away.

Chapter 14 gives you some additional tools to effectively deal with these problem tenants. I also describe the best way to handle common tenant problems and the pros and cons of alternatives to an eviction. But because avoiding eviction doesn't always work, I make sure you have everything you need to know to go to court, present a winning case, and collect your judgment. Life is full of unexpected events, so I also include suggestions on how to cope with tenants who fall into bankruptcy, refuse to leave, insist on leaving early

or want someone else to take their place, have personal relationships that deteriorate during their tenancy, pass away at your property, or don't allow you access to properly maintain the property.

Maintaining the property

Are you familiar with the saying, "To own is to maintain"? When you have only a few rental units or are just starting out, you often do much of the maintenance work on your units yourself. But as you acquire more properties or advance in your primary career, you need to explore the benefits and consequences of using employees. If you own a larger property, having an on-site employee who's responsible for its day-to-day management is absolutely mandatory.

To keep your property in tip-top shape, you also need to work with outside vendors and suppliers who are pros within their industry. Always keep in mind that you get what you pay for and that maintenance can be one of the largest expenses faced by most landlords. Part IV helps you navigate the nitty-gritty, hands-on aspects of managing employees and contractors and maintaining your property.

Protecting your investment

Like many property managers, you probably consider your property an investment. If you continuously lose money, having the property isn't worth the hassle or the expense, right? Not to worry. Although you can't predict bad weather or crime, you can safeguard the value of your investment by

- ✔ **Being aware of environmental hazards that can occur:** Minimize your risk and be prepared for natural or environmental hazards such as storms, fire, carbon monoxide gas, or mold. See Chapter 18 for details.
- ✔ **Buying the necessary insurance:** You can't avoid buying insurance, so I make sure you know enough to be dangerous when your insurance agent says you need coverage for snowstorms at your duplex in Phoenix. Chapter 19 covers the types of insurance you need to consider.
- ✔ **Increasing your cash flow:** Sometimes, recouping all the costs for your property isn't easy, so you may need to find ways to get more cash in your hands. As you discover in Chapter 21, a wide assortment of options awaits, including government-subsidized housing programs, special niche housing markets, and different lease options.
- ✔ **Keeping detailed records:** You're going to be so successful as a rental owner and manager that I need to make sure you have good record-keeping and financial reporting so you can keep track of all the money you make. Chapter 20 reveals some simple ways to handle filing.
- ✔ **Paying your taxes:** Property taxes are a reality of life almost everywhere. Chapter 19 makes sure you know how they're calculated and what you can do to minimize your tax payments by appealing your property's assessed value when market conditions decline.