

Negotiating Management Contracts

Outline Expectations Before Signing

By April Austin

Drawing up a contract for management services looks at first glance like a simple task. Such contracts usually follow a particular format and outline similar services for both co-ops and condos, regardless of size. But what about contract areas where there's room for negotiation? How can a board and a management company arrive at a contract that helps foster a cooperative relationship?

Tough Times, High Expectations

Even in a turbulent economic situation, the job of a manager comes down to a set of key functions, says Herb Rose, president of Herb Rose Consulting, a management consulting firm in Manhattan. "A management company has two functions, basically," he says. "They have to collect the maintenance and whatever other income is due to the co-op or condo, and they have to pay the bills.

Everything else is a variation of these two things, but when you make a contract with the managing agent, certain services can be delineated, and there are special contracts that are not going to be included in the services."

Negotiating those variations is where—as with so many things, communication is the key to success. The discussions that take place before anyone signs on the dotted line can help fill in the gaps on boilerplate management contracts. It's also helpful to understand what expectations each side brings to the table, says Greg Carlson, founder of Carlson Realty, Inc. in Forest Hills and the executive director of the Federation of New York Housing Cooperatives & Condominiums (FNYHC).

"I think that a lot of the work and the homework that needs to be done when you're doing a management contract is way before you even get to the contract stage," says Carlson, who is himself a certified property manager. "You should know what you want—the detail items that you want the managing agent to perform—so that when you get to the contract stage, it's just a matter of fact."

"The board of directors has to speak with one voice," adds Rose. "Otherwise, you'll have somebody from the board saying, 'We want this,' and somebody else from the same board saying the exact opposite. Beyond that, there should be an understanding as to what the fees would be for special projects. Will they be paid by time, or will they be paid by project? Because there are all kinds of miscellaneous projects that have come up that are not part of regular work. The list is endless, but I still come back to the first thing, which is that the board has to speak with one voice and work with their management contact."

A Lengthy Process

With so much at stake, choosing a management company can be a lengthy and detailed process. Prospective management companies are often called back for multiple interviews, and boards frequently go beyond the basic checklist of services and delve into specific line items in contracts before signing with a particular agency.

Boards usually begin with a basic contract provided by either the board or association attorney or the management company and customize it to meet their circumstances. The contract, which can be as few as three pages or more than 30, covers the following areas:

- Compensation – spells out what routine services the company provides for a base rate, and delineates non-routine or extra services that require additional payment, often calculated by the hour.
- Manager’s availability– explains how often the management company’s representative will be on the property, what meetings he or she will attend, and how emergencies will be handled.
- Authorization– determines what the management company is allowed to do and under whose authority (and whose signature is required).
- Indemnification– involves the co-op or condo association’s responsibility to cover a management company in the course of doing its job. This is the most negotiated area of management contracts, according to attorney Stephen Marcus of Marcus, Errico, Emmer & Brooks, PC, in Braintree, Massachusetts.
- Termination– provides guidance for canceling the contract based on state law.

Routine vs. Special Services

Most management companies offer similar routine services, including bookkeeping, community mailings, and other administrative work. They expect to spend a certain amount of time on-site doing paperwork, overseeing staff, and attending meetings with the board and homeowners.

Before engaging a property, management firms generally try to learn upfront whether a building’s board has had frequent turnover, which may signify some dysfunction, and whether the residents make frequent demands, which would require more of the manager’s time. It’s particularly important for a manager to do some due diligence, paying close attention to the building’s financial picture and overall physical maintenance situation before submitting a service contract. "Any management company that's got some kind of sense will do due diligence and find out what kind of problems there may be," says Rose. "You get the financial statements. You see what they've been, and whether they have unpaid bills. A savvy management company will go into this stuff and look for the history of repairs and the history of what the building does with its finances."

According to Michael Berenson, president of Manhattan-based management firm AKAM Associates Inc., "We won't give a price for management until we have walked the property and had an initial meeting with a potential client to discuss what projects they have coming up over the next five years. And then we look at what the staff has done, what they've deferred, and what they are looking to do. Because if they have major repairs that need to be made to the roof, for instance,

and it's leaking and they are going to continue to defer that, we have to examine if we want the property."

Other Extras

"We live in the city—where all of a sudden—the city, the state or the federal government will throw new regulations on buildings that were not foreseen when they first negotiated their management contracts," says Carlson. "Management companies live on very thin profit margins, so time is money to them, and you have some capital improvements that always, always need management oversight. Even though you may have an engineer or a consultant, they may come on an interval basis; they show up, they approve the invoice, and they look at the work, but it's the management company that deals with the everyday little problems and coordination of what needs to be done."

Along with overseeing major projects, insurance claim resolution and court appearances in lawsuits involving the condominium are two of the biggest black holes of time for property managers. Contracts should delineate exactly how much extra the manager expects to be compensated for his or her time. For example, an appearance in claims court might be billed at \$75 to \$100 an hour. In cases in which the manager is coordinating the resolution of an insurance claim, the management company may charge an additional 10 to 20 percent of the adjusted claim, which is billed directly to the insurer. Co-op boards and condo associations should be aware of these situations and decide in advance how they will handle them.

The contract should also make clear a property manager's role when contractors do work on the premises. Usually, he or she is involved in the administrative aspects, such as searching out contractors for bids, helping the board facilitate financing paperwork, or collecting extra fees. Other duties may involve coordinating access to the construction site and fielding complaints from owners. But this is project management, not a hands-on role. If the co-op or condo board wants a more direct supervisory role of contractors, it would pay extra for that individual to serve as construction manager.

Authorization

Contracts should also spell out the limits of a manager's authority. The client building should have in writing what management can do without board approval, and under what circumstances, say the professionals. Requiring dual signatures on checks or purchase orders—the manager's plus a designated board member's—is a good idea, he says, but it can also be a pain to chase people down. But if dual signatures aren't required, the board needs some other financial oversight mechanism.

Management companies will also ask that one person from the board be appointed as their contact, so information is funneled efficiently through that one individual.

Once the routine services and authorization have been sorted out, a condo association will want to look carefully at indemnifying their management company.

Insurance companies are increasing the number of exclusions in their liability policies (especially around hard-to-pin-down issues such as discrimination or even mold). Some will pay a claim but not the judgment. In most cases, when unit owners bring suits, they include everyone as defendants—including property managers and board members. Most firms recommend that, at minimum, the policy name the manager along with the individual board members of the association. The gold standard of coverage is insurance that covers not just negligence but “errors and omissions,” but this can carry a high premium.

Termination

Most contracts are good for one year and are usually in place for about three years. Some management companies build a rollover into their contracts. This means their contract is automatically renewed each year, which protects them from being caught short if an association board stalls on renewing the contract and then cancels it at the last minute.

Generally, says Berenson, the length of a contract is negotiated differently by each building. "Our standard contract is one year, but some buildings are looking for a longer term. The only differential in the contract between a one-year and a three-year or longer term is just the fee structure. If we work out a deal for three years, we figure out the rates for the next three years. If it's a one year deal, it's figured out upfront, just for the one year and then thereafter, it's negotiated. Some boards like to have it fixed for a longer period of time, so they know that the pricing is for the next three or four years."

If a relationship between client building and management firm deteriorates so far that termination is being discussed, it's usually too late to fix things. But some managers want the option of 60 days to address any problems.

The contract's termination clause should stipulate how financial and other records will be handed over, if any confidentiality agreements need to be signed, and how to conclude business with the management company. "Most management companies in New York work on the Real Estate Board of New York (REBNY) transition guidelines," says Berenson. "For the most part, the larger management companies are members of REBNY, and we all abide by their transition guidelines, which states what materials need to be transferred over, and in within what time period. It's pretty detailed as far what has to happen during a transition. A normal transition or termination clause in a contract could be 30 days, 60 days or 90 days depending on what's negotiated."

Like a prenuptial agreement, it's always a good idea to lay out every possible situation—and then have a lawyer sign off on the final wording.

Communication

No matter what the particulars of a management contract may be, the pros agree that communication is the crucial element to a successful board /management relationship.

They have to be able to talk to each other," says Rose. "There has to be a simple way for them to work out problems. No matter what you deal with, there must be a working relationship among the board itself."

And how you communicate, and the needs your building has, are unique to your building community. "Each building has its own personality," says Carlson. "You can have two buildings standing next to each other that were built exactly the same, same year, same architect, everything's the same, but they both have different personalities." All the more reason to make a considered decision when it comes to your management contract.