

Chapter 20: Property Management and Leases

An * in the left margin indicates a change in the statute, rule or text since the last publication of the manual.

I. General

Over the years, residential and commercial property management have developed into complex and profitable real estate specialties. Property managers are responsible for many trillions of dollars in real property market value on a long-term basis. Many firms are devoted exclusively to property management, and others have set up autonomous property management divisions to profit from the economic stability of management income during periods of slow sales activity. Some other firms simply do occasional property management as an accommodation to their sales listing clients.

Property managers offer a variety of extensive services and shoulder varying degrees of responsibility in the performance of their duties to the owners and tenants. Property managers are considered to be **general** agents, performing multiple functions as compared to sales licensees who, as **special** agents, are employed for a limited duration to market a specific property.

Whatever the scope of the management, if a broker or brokerage company is soliciting tenants, executing leases, collecting rents and security deposits, supervising repairs and improvements, and collecting a fee for such services, that person or company is performing property management and should become very familiar not only with this chapter, but also with Chapter 19 (Escrow Records), Chapter 25 (Colorado Fair Housing Act), and Chapter 4 (Subdivision Laws-Condominium Ownership Act).

Occasionally employed brokers are tempted to perform residential property management without their employing broker's knowledge or consent. Section 12-61-103 (10) requires all business to be conducted only in the licensed name of the employing broker. Employing brokers must be aware of their employed brokers' activities and should have a clearly written policy as to the firm's offering of management services.

The increasing use of computers and various software programs has improved the profitability and efficiency of property management as well as homeowner association management. However, software programs vary considerably and property managers should thoroughly study any application prior to implementation. Some commercial software programs may lack the ability to customize formats for residential clients. Some managers have developed record keeping systems using word processors or accounting systems. The suggested forms in Chapter 19 may be helpful whether using computerized, manual or a combination of both types of record keeping.

Property managers face challenges of age of construction, cash flow requirements, vacancy rates, heating/cooling concerns, electrical/plumbing needs, as well as EPA guidelines for radon, asbestos and lead-based paint plus both federal and state fair housing and civil rights regulations. Additionally, sound management and accounting practices must be followed to avoid commingling of funds among the properties managed.

Professional property managers perform a variety of functions and must be able to advise on: heating, cooling, painting, decorating, roofs, pests, insurance, the sales market, household appliances and to know when to refer to other professionals such as financial or tax advisors or attorneys. Property managers should be adept at problem resolution, negotiations, accounting, budgeting, sales and even psychiatry!

A working knowledge of landlord/tenant law, access to a competent attorney, effective communication skills, the ability to organize and delegate effectively as well as good time management skills and stress reduction techniques are also necessary to efficient property management. While an average sales licensee may handle two or three transactions a month, a professional property manager with an inventory of 200 units may be executing 5-6 leases, as well as collecting and disbursing income from all 200 units every month. The dollar value of each transaction may be smaller, but the manager is most often responsible for the entire value of the property and over an extensive period of time. The skills involved are equally important. A homeowner association manager may handle 1000 units comprised of many small or several large communities.

At the outset, a property manager must clearly understand the owner's needs and desires for the property. Management plans must support the owner's objectives of short or long-term ownership, long-term investment or other income needs. As the management contract continues over time, the manager must excel at clear and prompt communications with the owner.

A property manager may decide to specialize in a particular type of property or to service many types. Property management specialties may include:

- Single family homes, attached or detached (condos, townhomes)
- Multi-unit buildings (residential or office)
- Government-assisted housing
- Retail properties
- Shopping centers
- Office or industrial complexes
- Resort or short-term rental properties[†]
- Homeowners Associations[†]

([†] A Colorado real estate license is not required for these two specialties, or for those exempt under the provisions of C.R.S. 12-61-101(4) who lease or manage apartment buildings. However, many such specialists are Colorado real estate licensees, sometimes because they perform other activities that do require a license. Accordingly, brokers who perform services that may not require licensure must still follow the Commission E-Rules applicable under their employment agreements. See commission position statement CP-19, Short Term Occupancy Agreements.)

Several national organizations exist to assist property managers in the various management specialties. Each offers a wealth of information, networking opportunities, referral services as well as professional education courses and designations.

NARPM: The National Association of Residential Property Managers. P.O. Box 140647, Austin, TX 78754-0647, 1-800-782-3452. Appealing to managers of smaller residential properties: single-family homes, individual condos or townhomes and 2-12 unit apartment houses, **NARPM** is independent of the National Association of REALTORS® and does not require members to be REALTORS®. **NARPM** does require its members to hold a real estate license except in those states in which no license is required for property managers. There are Chapters of **NARPM** in both Denver and Colorado Springs with members throughout the State. Several professional designations are available.

IREM: The Institute of Real Estate Management. 430 Michigan Avenue, Chicago, Illinois 60611-4087, (312) 329-8458. This organization is an affiliate of the National Association of REALTORS® and requires its members to be REALTORS®. **IREM** awards the Certified Property Manager (CPM) designation to those members who successfully complete a rigorous series of courses. **IREM** is tends to draw managers of commercial ventures or large apartment houses.

CAI: The Community Associations Institute. 1630 Duke St., Alexandria, Virginia 22314, 1-703-548-8600. This group is independent of the National Association of REALTORS® and specializes in the concerns of professional homeowners association managers. There are active chapters in both northern and southern Colorado. CAI awards several professional designations.

BOMA The Building Owners and Managers Association.

The National Apartment Association

The six organizations listed in Part 7 of this Chapter offer literature, seminars and other information to improve their members' professionalism.

II. Management Functions

A property manager's primary concern should be to obtain the highest possible income stream consistent with protecting the owner's capital investment and preserving a good owner-manager-tenant relationship.

The following list, although not all-inclusive, serves to outline what may be normally expected of a property manager:

1. Establish the rental schedule.
2. Merchandise the space and collect the rents.
3. Supervise maintenance schedules and repairs.
4. Develop a tenant relations policy with tenant unions and tenants desiring a representative voice in the management of the project.
5. Develop employee policies and supervise their performance. Have an employee manual of policies and instructions.
6. Maintain proper accounting records and make regularly scheduled reports to the owner.
7. Qualify and investigate tenant credit.
8. Prepare and execute leases.

9. Prepare decorating, renovation or repair specifications and secure estimates.
10. Hire, instruct and maintain qualified and willing personnel to staff the building(s). Expect results.
11. Audit and pay bills, account for return or forfeiture of tenant security deposits.
12. Advertise and publicize vacancies through appropriate media.
13. Plan and supervise alterations and modernizing programs.
14. Inspect vacant space frequently and periodically.
15. Keep abreast of the times and keep posted on competitive market conditions.
16. Pay insurance premiums and taxes. Recommend adequate insurance coverage.
17. Keep abreast of health and building code standards requiring public buildings to meet all safety standards.
18. Provide for maximum-security provisions, knowing that the landlord is responsible for reasonable measures to safeguard tenants against intruders.
19. Develop an annual budget for the financial operations plan with the owner.
20. Manage affairs for homeowner associations. See Chapter 4.

The property manager's responsibilities do not end with the collection of rents and reporting income and expenses. The professional manager must be equipped to counsel the owner on a myriad of problems including the following:

1. Analyses and recommendations regarding vacant land, proposed and existing buildings.
2. Economic analyses and supervision of planned remodeling and renovation.
3. Economic surveys and analyses of trade areas.
4. Tax ramifications and insurance coverage.
5. The economics and negotiations of mortgage financing.
6. Budgeting for operating cash flows and unexpected costs or seasonal fluctuations in rental income.

Each property and category has its own character and its own set of problems. When taking on an unfamiliar assignment, an unwary broker may be overburdened with property management problems and may have to choose between neglecting the brokerage business or facing the wrath of an irate owner. A broker performing property management must recognize his/her staff's time and experience limitations.

Property management is a time consuming process and manpower scheduling is a prevalent problem. A shortage of qualified personnel is no defense for failure to fulfill fiduciary or contract duties to an owner. A competent manager should not assume additional accounts without adequate time or the technology to service them.

The property manager and owners business relationship is based on a current written management agreement. A manager should also have a current written agreement executed by tenant and landlord. If a lease is not required, all agreements concerning both parties'

privileges and responsibilities should be in writing and signed by the parties concerned. It is wise to secure the owner's written consent for significant changes in such duties or other special services to be performed by the broker on behalf of the owner.

The management of short-term occupancies (30 days or less) under a broker's license requires diligence in complying with C.R.S. 12-61-113(l)(g), (g.5) and (q). Complaints against licensees can generally be categorized into three areas: a failure to plan for the seasonal cash flows inherent in vacation rental management; a failure to supervise and properly maintain required records and accounts; a failure to disclose how management fees and commissions are earned in both the management agreement and reservation/cancellation policies. Please refer to "short-term occupancies" in the Index for further information.

Finally, the property manager must consider the rights and interests of the tenant in ongoing or in temporary management during the listing period. The broker should consult the owner and tenant when scheduling showings of listed property. See Chapter 25 for federal and Colorado fair housing considerations.

General information regarding tenant/landlord disputes is available from the Community Housing Service (303) 831-1935 or the **Resident Relations Help Line** (303) 320-1611.

III. Merchandising Rental Space

Rental space reacts to changes in supply and demand in the market place. A manager needs to estimate the strength of consumer pressure. Consumers normally shop the market and rent the space which best meets their financial and aesthetic needs.

As a rule of thumb, it takes five qualified prospects per unit to lease out a property. If more are required, then something may be wrong with the price, the manager's effort, or the attractiveness of the property. If the property rents on the basis of a rental for every qualified prospect, then price should be strengthened. These ratios, of course, vary with the character of the particular building. Furnished apartments for example, may rent with one renter to three prospects whereas deluxe units may require six to nine prospects per rental.

It is imperative that a property manager counsel owners carefully prior to taking over an account and identify which problems may be curable and what may not. For example, a building that is not soundproof is not economically feasible to cure and as a result it limits the clientele to quiet people.

If a property suffers from cumulative maintenance problems, a disproportionate amount of time may be required of a property manager, thus causing management expenses to exceed potential fee income. Buildings that have been cheaply constructed and suffer from accelerated obsolescence are extremely vulnerable to rental competition from newer buildings, again contributing to higher turnover. One short-term owner savings is to forego a preventive maintenance program. Preventive maintenance normally costs much less than paying to correct serious deferred maintenance problems.

Many apartment buildings are over-encumbered as a result of improper initial projections, or rent schedules barely sufficient to meet operating expenses and debt service even at 100% occupancy. This should be ascertained in advance in order to avoid negative cash flow. These cash shortages have often led to inadequate maintenance. The effect is cumulative and may seriously affect the future ability to maintain high occupancy. A

manager must judge each property on its own merits before deciding whether or not to manage it.

Brokers who wish to engage in property management should carefully study the chapter on escrow records. No area of real estate needs more diligent records maintenance than property management.

Rental location agents are defined in C.R.S. 12-61-101(2)(j) and 113(1.5). Brokers who receive advance fees from prospective tenants for furnishing information on available rentals must keep records of such funds according to C.R.S. 12-61-113 (g) and Rule E-1.

IV. General Accounting Concepts

A licensed property manager is a trustee primarily responsible for the supervision, accounting and use of “money belonging to others.” Any recallable trust account cash balance must always equal the corresponding trust account contractual liability at the same point in time. Trust accounts are generally maintained on a “cash basis”. Funds belonging to one owner may never be “loaned” as unauthorized supplemental operating capital to finance expenditures of other owners (or the broker). (See C.R.S. 12-61-113(1)(g), (g.5), (n); Rules E-1(f), (g), (p), (q), E-29, and E-30).

The following relationships govern operation of all double entry management accounting systems:

BALANCE SHEET

ASSETS	=	LIABILITIES	+	CAPITAL & RESERVES
<u>Debit</u> <u>Credit</u>		<u>Debit</u> <u>Credit</u>		<u>Debit</u> <u>Credit</u>
Increase	=	Increase		Increase
Decrease	=	Decrease		Decrease

Assets: cash balances for unpaid owner income, tenant security deposits, advance rental deposits, owner cash reserves, owner inventory and equipment on the property.

Liabilities: mortgage principal, taxes, tenant or guest deposits.

Capital: owner reserves, equipment replacement reserves, owner draws from net income earned, net income and retained earnings.

INCOME STATEMENT

NET INCOME	=	REVENUE	-	EXPENSE
<u>Debit</u> <u>Credit</u>		<u>Debit</u> <u>Credit</u>		<u>Debit</u> <u>Credit</u>
Increase	=	Increase		Increase
Decrease	=	Decrease		Decrease

Revenue: Rent receipts, late fees, forfeited tenant deposits, utility charges collected from tenants, other operating income payable after expenses to the owner. Owner payments to provide working capital (reserves) are not property income.

Expense: Payments or journal entries to record the cost of operating the property under the terms authorized in the management agreement or lease or addendum thereto.

In the context of rental management, cash receipts generally increase assets, net income and capital. They are debited to cash and credited to the appropriate liability, revenue or a capital account. Cash disbursements decrease (credit) a cash account and are debited to the appropriate liability, expense or capital account.

The accounting system in a large management operation should have the capability to integrate owner/tenant/property/service activity and non-financial marketing data with the accounting transactions. The system should provide the capability to reproduce reports, data, and bank reconciliations upon demand for any prior period. The accounting/management database should allow access to immediate information for:

- Tenant/guest amounts owed versus collected:
- Tenant by name/unit charges and receipts.
- Common area charges/special package prices.
- Tenant unit rental history/personal data.
- Deposits collected or held by current broker.
- Leases/agreements/amendments/coming expiration dates.
- Correspondence/evictions/addenda.
- Scheduled occupancy/vacancy dates.
- Accounting for security deposit refunds.
- Late fees and other tenant charges.
- Properties/units under management:
- Property /unit identification /marketing data.
- Owner/insurance /lender information
- Management agreements /amendments /correspondence.
- Vendors and scheduled payments for mortgages, etc.
- Maintenance /remodeling /written authorizations.
- Accounting reports /multiple bank account capacity.

The foregoing information is critical, but the accounting system to produce such data need not be expensive. Good word processing programs can maintain much of the management data required in transaction files. Several small business accounting software programs comply with the requirements of Rule E-1. A broker must train assistants, establishing appropriate office policies, and understand and oversee operation of the accounting system and any software or problems/complaints will soon develop.

Managers must disclose brokerage relationships to property owners and prospective tenants using approved commission-approved forms. For property owners, the broker is required to enter into the appropriate Exclusive Right-to-Lease Listing Agreement specific to the type of agency offered (either the current LC15 or LC35). As an alternative to the listing agreement, the broker may attach the Brokerage Duties Addendum to Property Management Agreement DBA 55, to management agreements executed with property owners. For prospective tenants, the broker must either enter into the appropriate Exclusive Tenant Contract specific to the type of agency offered or the current Brokerage Disclosure to Buyer. Also, the broker should disclose in writing the specific duties pertaining to the brokerage relationship offered to prospective tenants pursuant to Rule E-35. If a property owner or prospective tenant requests information about types of brokerage relationships other than

those offered by the broker, provide the client the current Definitions of Working Relationships.

Brokers must have written consent from the party assisted or represented to assess and receive any **mark-ups** and/or other compensation for services performed by any third party or affiliated business entity. (Rule E-l(p)(8)). The purpose of this rule is to facilitate full disclosure of all forms of compensation under C.R.S 12-61-113(1)(c.5), (q) and 6-1-105. This applies to management companies who mark-up the charges billed by independent maintenance companies, add a percentage to the cost billed by others for administrative overhead or receive any transaction specific income from an affiliated business entity. The broker must maintain office records that verify prior written consent for these amounts and account for the additional amounts or percentages charged to others.

V. Security Deposits

A. Introduction

Property managers may incur serious problems if they fail to properly handle security deposits. To avoid these problems, property managers should become thoroughly familiar with the requirements in the following provisions of the Colorado law:

Title 38, Article 12, C.R.S. 1973 Security Deposits-Wrongful Withholding

38-12-101. Legislative declaration.

“The provisions of this part 1 shall be liberally construed to implement the intent of the general assembly to insure the proper administration of security deposits and protect the interests of tenants and landlords.”

38-12-102. Definitions.

As used in this part 1, unless the context otherwise requires:

“Normal wear and tear” means that deterioration which occurs, based upon the use for which the rental unit is intended, without negligence, carelessness, accident, or abuse of the premises or equipment or chattels by the tenant or members of his household, or their invitees or guests.

“Security deposit” means any advance or deposit of money, regardless of its denomination, the primary function of which is to secure the performance of a rental agreement for residential premises or any part thereof.

38-12-103. Return of security deposit.

A landlord shall, within one month after the termination of a lease or surrender and acceptance of the premises, whichever occurs last, return to the tenant the full security deposit deposited with the landlord by the tenant, unless the lease agreement specifies a longer period of time, but not to exceed sixty days. No security deposit shall be retained to cover normal wear and tear. In the event that actual cause exists for retaining any portion of the security deposit, the landlord shall provide the tenant with a written statement listing the exact reasons for the retention of any portion of the security deposit. When the statement is delivered, it shall be accompanied by payment of the difference between any sum deposited and the amount retained. The landlord is deemed to have complied with this section by mailing said statement and any payment required to the last known address of the tenant. Nothing in this section shall preclude the landlord from retaining the security deposit for non-payment of rent, abandonment of the premises, or non-payment of utility charges, repair work, or cleaning contracted for by the tenant.

- The failure of a landlord to provide a written statement within the required time specified in subsection (1) of this section shall work a forfeiture of all rights to withhold any portion of the security deposit under this section.
- (3)
 - (a) The willful retention of a security deposit in violation of this section shall render a landlord liable for treble the amount of that portion of the security deposit wrongfully withheld from the tenant, together with reasonable attorneys' fees and court costs; except that the tenant has the obligation to give notice to the landlord of his intention to file legal proceedings a minimum of seven days prior to filing said action.
 - (b) In any court action brought by a tenant under this section, a landlord shall bear the burden of proving that his withholding of the security deposit or any portion of it was not wrongful.
 - (4) Upon cessation of his interest in the dwelling unit, whether by sale, assignment, death, appointment of a receiver, or otherwise, the person in possession of the security deposit, including but not limited to the landlord, his agent, or his executor, shall, within a reasonable time:
 - (a) Transfer the funds, or any remainder after lawful deductions under subsection (1) of this section, to the landlord's successor in interest and notify the tenant by mail of such transfer and of the transferee's name and address; or
 - (b) Return the funds, of any remainder after lawful deductions under subsection (1) of this section to the tenant.
 - (5) Upon compliance with subsection (4) of this section, the person in possession of the security deposit shall be relieved of further liability.
 - (6) Upon receipt of transferred funds under subsection (4)(a) of this section, the transferee, in relation to such funds, shall be deemed to have all of the rights and obligations of a landlord holding the funds as a security deposit.
 - (7) Any provision, whether oral or written, in or pertaining to a rental agreement whereby any provision of this section for the benefit of a tenant or members of his household is waived shall be deemed to be against public policy and shall be void.

38-12-104. Return of security deposit – hazardous condition – gas appliance.

- (1) Anytime service personnel from any organization providing gas service to a residential building become aware of any hazardous condition of a gas appliance, piping, or other gas equipment, such personnel shall inform the customer of record at the affected address in writing of the hazardous condition and take any further action provided for by the policies of such personnel's employer. Such written notification shall state the potential nature of the hazard as a fire hazard or a hazard to life, health, property, or public welfare and shall explain the possible cause of the hazard.
- (2) If the resident of the residential building is a tenant, such tenant shall immediately inform the landlord of the property or the landlord's agent in writing of the existence of the hazard.
- (3) The landlord shall then have seventy-two hours excluding a Saturday, Sunday, or a legal holiday after the actual receipt of the written notice of the hazardous condition to have the hazardous condition repaired by a professional. "Professional" for the purposes of this section means a person authorized by the state of Colorado or by a county or municipal government through license or certificate where such government authorization is required. Where no person with such government authorization is available, and where there are no local requirements for government authorization, a person who is otherwise qualified and who possesses insurance with a minimum of one hundred thousand dollars public liability and property damage coverage shall be deemed a professional for purposes of this section. Proof of such repairs shall be forwarded to the landlord or the landlord's agent. Such proof may also be

used as an affirmative defense in any action to recover the security deposit, as provided for in this section.

- (4) If the landlord does not have the repairs made within seventy-two hours excluding a Saturday, Sunday, or a legal holiday, and the condition of the building remains hazardous, the tenant may opt to vacate the premises. After the tenant vacates the premises, the lease or other rental agreement between the landlord and tenant becomes null and void, all rights and future obligations between the landlord and tenant pursuant to the lease or other rental agreement terminate, and the tenant may demand the immediate return of all or any portion of the security deposit held by the landlord to which the tenant is entitled. The landlord shall have seventy-two hours following the tenant's vacation of the premises to deliver to the tenant all of, or the appropriate portion of, the security deposit plus any rent rebate owed to the tenant for rent paid by the tenant for the period of time after the tenant has vacated. If the seventy-second hour falls on a Saturday, Sunday, or legal holiday, the security deposit must be delivered by noon on the next day that is not a Saturday, Sunday, or legal holiday. The tenant shall provide the landlord with a correct forwarding address. No security deposit shall be retained to cover normal wear and tear. In the event that actual cause exists for retaining any portion of the security deposit, the landlord shall provide the tenant with a written statement listing the exact reasons for the retention of any portion of the security deposit. When the statement is delivered, it shall be accompanied by payment of the difference between any sum deposited and the amount retained. The landlord is deemed to have complied with this section by mailing said statement and any payments required by this section to the forwarding address of the tenant. Nothing in this section shall preclude the landlord from withholding the security deposit for nonpayment of rent or for nonpayment of utility charges, repair work, or cleaning contracted for by the tenant. If the tenant does not receive the entire security deposit or a portion of the security deposit together with a written statement listing the exact reasons for the retention of any portion of the security deposit within the time period provided for in this section, the retention of the security deposit shall be deemed willful and wrongful and, notwithstanding the provisions of section 38-12-103 (3), shall entitle the tenant to twice the amount of the security deposit and to reasonable attorney fees.

B. City Ordinances Concerning Security Deposits

The City of Boulder requires payment of a stated rate of interest to a tenant for any security deposit held under a residential lease. This excludes leasing of mobile-home park space. The person in possession of the deposit must return and account for the amount and interest due within thirty days after the latter of termination or surrender and acceptance of the lease. (Ordinances 4969 and 7158, Title 12-Chapter 2, Landlord/Tenant Relations). Brokers should check for similar requirements in other cities where leasing activity is conducted.

C. Guidelines for the Property Manager Regarding Security Deposits

A manager should inspect a property prior to occupancy and document the condition of the premises. When the tenant vacates and has caused no damage other than normal wear and tear, the deposit must be returned to the tenant.

Accounting for security deposits is extremely important and must be performed pursuant to Commission Rules E-1, E-16 and commission position statement CP-5, Advance Rentals and Security Deposits, in Chapter 3. These deposits must generally be placed into a security deposit escrow account and returned as soon as possible to the tenant, when refundable. The practice of making refund checks jointly payable to a tenant and a new property manager or owner only delays the refund process and may result in public complaints. Some owners and

management companies apply security deposits toward the last month's rent. This practice may result in owner liability because advance rental deposits may be subject to earning interest, whereas security deposits generally are not. The broker should review local or county ordinances for further information.

Both the management agreement and the lease or rental agreement should contain authority for the manager to control security deposits. If there is no written procedure pertaining to these deposits, each party to the agreement injecting his or her own ideas may result in confusion and resentment. Thus, it is best that both the lease and management agreement spell out in writing the intent of all parties to the contract concerning the disposition of security deposit funds. A broker may transfer tenant security deposits to a property owner only pursuant to commission position statement CP-5, Advance Rentals and Security Deposits. This position statement is summarized in Rule E-16; see also: "Offsetting Broker Expenses Against Refundable Deposits" in Chapter 19.

A written agreement is further useful in the event of change in ownership or management of a building. The new owner or manager may simply refer to the tenancy agreement to determine the amount of the deposit and the tenant has a copy as proof.

The amount of a security deposit varies according to the rent paid, size of unit, whether furnished or not and type of equipment included (i.e., washer, dryer, dishwasher, air conditioner, etc.). Policies vary and competition plays a part in the amount of security deposit that may be obtained, but a good rule of thumb would be 50 percent to 100 percent of one month's rent.

Unclaimed security deposits and other forms of "money belonging to others" must be reported and remitted by the property manager to the Colorado State Treasurer under the provisions of the "Unclaimed Property Act", C.R.S. Title 38, Article 13. Unclaimed property reports are filed by November 1 each year and must be accompanied with the unclaimed money. Unclaimed property is generally that which has been held for five years or more. Forms and instructions may be obtained from The Great Colorado Payback Offices, 1120 Lincoln Street, Suite 1004, Denver, Colorado 80203. (Telephone 303-894-2443 or 800-825-2111).

VI. Leases

A. Introduction

A lease is both a contract and a conveyance. It sets forth the terms of the agreement between the parties (landlord and tenant; lessor and lessee) whereby the right to possess and use the property for a certain period of time is transferred from one to the other. The interest in the property transferred may be nominal, such as a lease for one month; or it may be a very substantial 99-year lease. A lease for one year or less may be oral. A lease for longer than one year is required to be in writing to be enforceable under the statute of frauds. A written lease is always preferable because it furnishes objective proof of the terms agreed to by the parties.

A lease is an agreement between lessor and lessee whereby the lessee takes possession and receives the use and profits of an estate in real property for a certain period of time in return for which the lessor receives the lessee's performance and payment according to the conditions of the agreement.

B. Leasehold Tenancies

Leasehold estates can be classified into four types: (1) tenancy for years, (2) periodic tenancy, (3) tenancy at will, and (4) tenancy at sufferance.

Tenancy for years

A tenancy for years is for a fixed period of time, (e.g., one day, 99 years). The termination date is set at the time the lease is executed. A tenancy for years ends on the last day of the lease term, with no need to give notice.

Periodic tenancy

A periodic tenancy exists when the rental period is indefinitely renewable for a series of same durations (e.g., week-to-week or month-to-month). The most common example is a residential lease requiring a tenant to pay monthly rent, but with no definite termination date. Periodic tenancies are generally created by implication and not by an express provision. According to Colorado law, and that of most states, such tenancies require the giving of proper notice for their termination. Notice to terminate is discussed below under the heading of “termination of leases.”

Tenancy at will

A tenancy at will provides that either party may terminate the lease whenever he or she chooses to do so. A tenancy at will also exists when the agreement allows a tenant to occupy the premises until sold, or until the landlord is ready to construct a new building, or some other indefinite happening. Similar to a periodic tenancy, a tenancy at will requires the giving of proper notice for its termination.

Tenancy at sufferance

A tenancy at sufferance arises when a tenant remains in wrongful possession after a lease has ended. The tenant is called a holdover tenant. The landlord may treat the tenant as a trespasser and initiate eviction, or may elect to accept the tenant for a similar term and conditions as the previous lease. The choice is the landlord's; the tenant has none. If a tenant holds over due to reasons beyond their control, such as illness, the tenant may be held liable only for the reasonable rental of the holdover period.

C. Types of Leases

Ground lease

A ground lease is a tenancy for years whereby a parcel of unimproved land is let for a typically extended period of time. This usually allows a building to be erected on the land by the tenant and provides for the disposition of the building at the end of the lease. The landowner may become entitled to the building upon the payment of all, part or none of the value of the building, depending upon the agreement. In absence of agreement, the building legally becomes real property and belongs to the landowner who is not required to reimburse the tenant.

A long-term ground lease can offer considerable advantage to a tenant. When land values run as high as \$10,000 and more per front foot, considerable capital is required to invest in the land alone. Add the cost of a building to this, and the investment may exceed an

investor's resources. But under a long-term ground lease, the land part of the financing problem is solved. Such a lease may be considered as borrowing of the capital value of the land for the term of the lease. The ground rent paid to the owner is, in this sense, interest on the value of the land. The land itself plus the improvements erected by the tenant become security for the "loan". A transaction with such ample security is indeed a good investment for the fee holder. Big businesses and investors do not hesitate to deal with such long-term leases, provided the location involved is suitable to their purposes. In addition, long-term leases involve a tax advantage. If purchased, the price of land is a capital investment and is not deductible; in fact the ground is not even depreciable. But rent paid by a tenant is a deductible business expense. The landowner benefits from a reduced income tax liability on the rent received over the years compared to an immediate and large capital gains tax if the property had been sold to the tenant.

A long-term ground lease holds another advantage for an owner of valuable land lacking sufficient finances to develop it. An owner may induce a tenant to make suitable improvements by means of rent concessions. With appropriate improvements the fee holder's land will increase in value, said increase benefiting the owner at the end of the lease. Such leases often provide for the increases in value to be matched by increased ground rent at suitable intervals. This is what is known as a **step-up** lease or **graduated lease**. Two common ways to provide for these increases in rent are: (1) to provide for a fixed increase at stated intervals, or (2) to provide for the increase to be based upon the appraised value of the property, determined by an arbitration committee. Although the first method has the advantage of being clear and definite, it may be too inflexible to meet changing economic conditions over a long period of years. The second method involves an arbitration committee usually composed of one member selected by the tenant, one by the landlord, and the third selected by agreement of these two. This committee then applies a fixed capitalization rate to the appraised value of the property at regular intervals. This method establishes a currently reasonable rental, but may be difficult to implement if the committee members cannot agree. Some authorities on long-term leases claim that fixed rentals for the entire period give the greatest satisfaction to both parties, enabling stable, long-term business planning. Other authorities feel that such a fixed rental program works a hardship on the tenant in a recessionary period and a hardship upon the owner in an inflationary period.

Percentage lease

Percentage leases are used for commercial establishments, generally retail stores, and usually provide for a fixed minimum rent plus a percentage of the tenant's gross sales. Gross sales or gross income must be clearly defined and should provide for such things as returned merchandise, discounts for prompt payment made to customers, sales to employees, mail-order sales, services rendered at cost (such as clothing alterations), income from vending machines, etc. Detailed provisions should be made concerning the tenant's records and the landlord's right to examine or audit the tenant's books. Satisfactory use of percentage leases requires thorough knowledge and expert judgment.

Sky lease

A sky lease or lease of air space usually creates a tenancy for years, generally for a long period of time. In 1910, the Cleveland Athletic Club executed one of the first such leases, leasing the air space above a five-story building and erecting eight additional stories. The club paid rent for its space along with the improvement taxes, but not land taxes. The upper

eight stories were to revert to the lessor at the end of the term upon the payment of its appraised value. This type of lease is based upon the common-law right of a fee holder to use his or her land from the center of the earth to the dome of the skies. Today, the governmental right to regulate air traffic has limited this property right.

One of the most interesting utilizations of air space involves the Merchandise Mart in Chicago. The building is constructed over the tracks of the Chicago and Northwestern Railroad, erected on piers 23 feet above the earth's surface, leaving space necessary for the operation of the railway.

Within the state of Colorado there exist a few such leases or sales of air space. In 1953 the Colorado legislature enacted a statute enabling creation of estates, rights and interests in areas above the surface of the ground and transfer of such interests in the same manner as interests in land. (Title 38, Article 32, C.R.S.)

Net lease

A net lease requires the tenant to pay rent plus all or a substantial part of the cost of operations and maintenance. Various expressions are used in real estate to describe the many variations in net lease transactions. For instance, if a lease provides for the tenant to pay utilities, real estate taxes and assessments, etc., it might be referred to as "net" lease. If the lease additionally provides for the tenant to insure the premises, it might be referred to as "net-net". Both parties must be absolutely certain of their responsibilities in a net lease.

Gross lease

A gross lease is the opposite of a net lease. The rent typically includes all owner-paid operating costs associated with the premises.

Farm lease

Farm leases are based on the same principles as other leases. The farm tenant may pay rent based on a crop-sharing basis. The owner agrees to give possession to the land and improvements thereon, and perhaps to furnish the equipment, and the tenant agrees to furnish the labor and capital to farm the land in a sound, reasonable manner and to pay a specified share of the crops. Alternatively the rental may be a fixed sum. Farm leases vary in terms and conditions by region and community.

Farm management has become one of the leading and most specialized branches of real estate. A farm manager must know soils, crops most suitable to the various types of soils, land conservation techniques, and the numerous other things necessary for successful modern farming.

D. Elements of a Lease

As stated earlier, a lease is both a contract and a conveyance. As a contract it embodies the agreement of the parties. As a conveyance it transfers an interest in land, the right to possess and use it for a certain time. The following are the more common lease elements.

1. **Date:** Although not essential, a date can prevent controversy as to questions of time and related problems, such as the portion of the rent due for a partial month or year.
2. **Parties:** Must have legal capacity to enter a contract, and be clearly named and designated. If there are multiple owners or tenants, all should be parties to the lease.

3. **Consideration:** A lease is not enforceable without consideration. The lessee's payment (or promise to pay) and the lessor's delivery of (or promise to deliver) possession are typical considerations supporting the lease.
4. **Description of the property:** A lease must describe the premises with reasonable certainty. Tenancy of only part of an improvement, use of basement storage space, assignment of parking spaces, or other facilities should be clearly described.
5. **Words of Conveyance:** The lease should clearly state the extent and nature of the interest being conveyed, including the duration of the lease and the lessee's rights.
6. **Conditions and exceptions:** All conditions imposed on a lessee's tenancy and exceptions to the rights which normally accrue to a tenant should be set forth.
7. **Lessor's and lessee's covenants:** Any and all covenants to be fulfilled by either party should be included in the lease.
8. **Signatures:** A lease for longer than one year must be in writing and signed by the parties. The best evidence of the parties' mutual assent is a signed instrument. If a lessee takes possession without signing, only the lessor need sign to create a valid lease. The lessee's taking possession is evidence of assent to the lease.
9. **Seal:** A seal is not generally required, except in the case of corporations and governmental agencies.
10. **Delivery:** Like a deed, a lease must be delivered to be effective.
11. **Recording:** A lease need not be recorded to be valid. A long-term lease, may be extremely valuable and should be recorded. As a rule, a landlord does not furnish a tenant with title evidence, but in the case of a long-term lease, a tenant might require the owner to prove clear title.
12. **Acknowledgment:** A lease need not be acknowledged. Again, in the case of a valuable lease that will be recorded, acknowledgment of the signatures should be made.

Some other lease clauses which may apply: Cost-of-living adjustment; handling of the security deposits; use of premises; acceptance of the premises by lessee; surrender of premises at end of term; maintenance, repair and alterations of premises during term; responsibility for payment of utilities; personal and real property taxes; entry and inspection by lessor's agents; assignment and subletting; agent hold-harmless clause; repossession due to unpaid rent; abandonment of premises by the tenant; holding over; future sale of premises; cessation of lease by condemnation or destruction of premises; right of the lessor to mortgage or subordinate; sign regulation; renewal options; termination notice, disposition of deposits/records upon change of property managers, etc.

E. Termination of Leases

Leases may be terminated in four major ways: (1) expiration of the term, (2) surrender and acceptance, (3) breach of conditions of the lease, and (4) eviction of the tenant.

Expiration of the term of the lease

A **tenancy for years** ends on the last day of the term, with no notice-to-quit required. Colorado law states: "No notice to quit shall be necessary from or to a tenant whose term is,

by agreement, to end at a time certain.” (C.R.S. 13-40-107 (4)) If a lease is oral, the lessor should give the periodic statutory notice-to-quit in writing in order to avoid potential conflict over the term of the oral agreement.

To terminate a **periodic tenancy** and **tenancy-at-will**, the party (lessor or lessee) desiring to end the lease must serve a written notice to quit. The notice must describe the premises, state the time the tenancy will terminate, be signed by the party (or agent) giving such notice, and be served not less than a statutorily specified time before the end of the tenancy period. Required notice periods are:

- Year-to-year tenancy or longer: three months prior or earlier.
- Six months or more but less than a year: one month prior or earlier.
- Month-to-month or up to but less than six months: at least 10 days’ prior notice.
- Tenancy at will: minimum three-day notice (C.R.S. 13-40-107 C.R.S.).

Notice must be delivered to the tenant or other person occupying the premises, or by leaving a copy with some person, a member of the tenant’s family above the age of fifteen, residing on, or in charge of the premises or if no one is on the premises at the time service is attempted, by posting a copy in some conspicuous place on the premises.

Colorado law [C.R.S. 13-40-107.5 (1)] provides for a three day expedited eviction of certain “undesirable and dangerous persons” who demonstrate that they (or their guests) are “unfit to coexist with their neighbors and co-tenants” by committing infractions known in the law as “substantial violations”. These include various violent or drug-related felonies as well as endangerment of person and property. These acts are considered severe enough to give the landlord a remedy of expedited eviction. However, the statute specifically states that victims of domestic abuse, and persons who could not have reasonably known of or prevented the “substantial violations,” but did immediately notify law enforcement are exempt from any expedited eviction action.

A holdover tenant is not entitled to notice to quit. If a lease is for a definite term and the tenant does not surrender possession of the property at the end of the term, the landlord may elect to hold the tenant for a like term. Such election must be accompanied by some act on the part of the landlord that signifies an intention to accept the tenant, such as receiving the next rent payment. Unless the landlord in some way indicates intent to retain the tenant, the tenant remains a tenant at sufferance.

The tenant does not have any right of election in such a case, only the landlord. It is a common practice, and potential pitfall to include in the lease an automatic renewal clause which provides that unless an agreed upon notice of a certain number of days (e.g. 30 or 60) is given by either party, the lease shall be continued automatically from the end of the term for a like period.

Surrender and acceptance

A mutual agreement to terminate a lease without obligation on the part of either landlord or tenant is a termination by surrender of the lease and an acceptance thereof.

Breach of conditions

Failure by either lessor or lessee to perform agreed upon conditions or covenants constitute a breach of the lease and may permit the injured party to cancel the lease.

Eviction of the tenant

An eviction may be either actual or constructive. Actual eviction occurs when a tenant is ousted from the premises, completely or partially, either by an act of the landlord or by someone with superior title. Constructive eviction occurs when the leased premises deteriorate to such physical condition, owing to some act or omission of the landlord, that the tenant is unable to use the premises for the purpose intended. Failure to furnish heat or other facilities contemplated by the lease or any other deprivation of use by the lessor is also a constructive eviction.

Termination under other conditions

If leased property is taken for public use by condemnation, any lease is terminated. The tenant is entitled to compensation for the value of the unexpired portion of the lease, and the tenant's claim is superior to that of the landlord.

The foreclosure of a mortgage or other lien may terminate the lease. If the mortgage or other lien was prior in time to the lease, and the tenant had either actual notice or constructive notice of the lien, then foreclosure will terminate the lease.

F. Duties and Liabilities of the Parties

A carefully drafted lease will clearly set forth all the duties and responsibilities of the parties, and avoid ambiguities that might lead to controversy. Absent a complete written lease setting forth all terms, the law presumes certain agreements on the part of the parties. For instance, unless there is an agreement to pay rent in advance, the law presumes that rent is not due until the end of a rental period.

A tenant may use the premises in any lawful, appropriate way not expressly restricted in the lease. If the premises are unsuitable for the specified purpose of the lease, the landlord, unless having agreed to do so, need not remodel the property but the tenant may do so. A commercial landlord may compete or lease to a competing business within the same building unless the lease so prohibits.

A lease of business property automatically gives a tenant the right to maintain signs on the leased property advertising the business. Unless expressly granted, no such right to advertise exists for leased residential property, such as a doctor, real estate broker or other professional maintaining an office in a leased residence.

In multiple-unit commercial or residential property, the landlord has a duty to keep the premises warm and habitable, unless each unit has its own facilities. Provisions as to the furnishing of gas, electricity, heat, hot water, or other services should be incorporated in the lease.

Unless a lease provides otherwise, a landlord is generally not required to keep the premises in repair. Neither is the tenant required to make repairs. Provision for repair and for the scope of the duties of the party obligated to keep the premises in repair should be clearly delineated. An agreement to repair does not impose the duty to rebuild if the premises are accidentally destroyed. A landlord is not required to repair and make habitable property that is uninhabitable at the time of making the lease. The tenant is presumed to have full knowledge of the condition of the property and should specify any desired repairs.

A lessor has no right to enter the leased premises. A landlord's right to enter upon the premises to inspect the property or to show it to prospective purchasers or lessees is limited to what is spelled out in the agreement.

As a general rule, a person occupying the property is liable to others for injury caused by the condition of the property. An occupant is also liable to others for any nuisance resulting from the occupant's use that interferes with others' use and enjoyment of their property.

A landlord is not generally liable for injury to a tenant or a tenant's family caused by the property's condition, unless such condition is latent (hidden) and the landlord had knowledge of such latent, dangerous condition. A landlord may be held liable to persons using the sidewalks or highway abutting on the property for injury caused by dangerous conditions on the property. In such a case, a landlord's liability continues only until a reasonable time after the tenant takes possession and has opportunity to correct the dangerous condition, whereupon the tenant becomes responsible. It is advisable that the parties agree as to responsibility for injury to other persons, and for the responsible party to secure protection by means of liability insurance.

A landlord usually retains control over entrances, hallways, elevators, stairways and other portions of multi-unit property. In such cases the landlord is liable for injury to the tenants, their guests or business visitors caused by dangerous conditions in these areas resulting from landlord negligence. As a general rule, partial or total destruction of the premises by fire or other accident does not relieve a tenant from the obligation to pay rent. Some states feel this common-law rule is too harsh and have enacted statutes stating that destruction or damage making the property unfit for occupancy terminates the lease and relieves a tenant from paying rent. It is strongly recommended that lease provisions cover such emergencies.

Unless the provisions of the lease prohibit, a tenant may assign or sublet the premises. The lessee would remain liable to the lessor for the performance of all the original lease conditions. Most leases prohibit subletting or assignment without the lessor's prior consent.

A landlord who re-enters leased premises effectively evicts the tenant and relieves the tenant from all liability for future rent, unless the lease specifies otherwise. If the lease authorizes a landlord to re-enter and re-let the premises without terminating the lease in the event a tenant vacates the premises, a court may hold the tenant liable for rent the tenant agreed to pay, less any amount the landlord received from the new tenant. Many lease agreements provide that upon tenant default a landlord may: (a) declare the term of the lease ended, re-enter the premises, expel the tenant, and take possession of the premises; or (b) re-let the premises, apply the rent from the new tenant's lease to the lease of the old tenant, with the old tenant being responsible for any balance due.

The above discussion should indicate the extreme desirability of having a carefully drafted lease, clearly setting forth all the conditions and covenants of the tenancy and all the duties and responsibilities of each party.

VII. Sources of Information and Training

- The National Center for Housing Management under the sponsorship of the Department of Housing and Urban Development of the U.S. government.
- The National Association of Homebuilders.
- The National Apartment Association.

- The Institute of Real Estate Management associated with the National Association of Realtors.
- Building Owners and Managers Association.
- Educational Institute for the American Hotel & Motel Association

These national associations usually have local chapters affiliated with them. The national organizations collect income and operating expense figures from their members. The expense ratios are useful guides which managers use to check their individual properties' operating expense against the average expense shown for that city. Several associations offer educational courses and information useful in all forms of property management.

VIII. Mobile Home Park Tenancies

Colorado law specifically provides for the method of termination of a lease in a mobile home park. Management must give written notice to remove an owner's unit from the premises within not less than thirty days (or not less than sixty days to remove a multi-section home) from the date notice is served. The manager must provide the homeowner with a statement of reasons for termination. Management may increase rent only after sixty days written notice to the homeowners.

The law also covers regulations of tenancy, amount of security deposits, fees or fines, collection of utility charges, etc. (Title 38 Article 12, C.R.S.) The Mobile Home Park Landlord-Tenant Act is printed in Chapter 26 of this Manual.

