OWNERSHIP CONCERNS

Introduction

The primary responsibility of the property manager is to assist the owners in achieving their investment objectives for their real estate properties. Before planning management and marketing programs, the property manager must have a mutual understanding of what the owners want from their investment. Because these objectives will differ from one investor to another, it is essential that discussion is thorough and that the essence is written in the management plan.

Reasons for Investing in Real Estate

Some reasons for investing in real estate are:

1. To receive periodic income
2. To achieve value enhancement
3. To house business functions
4. To speculate
5. To build an estate
6. To hedge against inflation
7. To be able to take pride in ownership

Some of these investment purposes are inter-related or interdependent. The quality of management is essential to receiving income and to achieving capital appreciation. One is often not possible without the other. Management quality will certainly influence whether the owners can take pride in ownership. It may influence the outcome of the other reasons for investing, as well.

How the Manager Can Realize the Owners' Goals and Objectives

Discuss with the owners their goals and objectives to ascertain what they are and to be sure there is mutual understanding.

Occasionally new owners are unsure or unaware of what they can expect. In this case, you can present them with alternative ideas based on your experience.

With the owners' goals and objectives in mind, plan operating procedures, marketing procedures, and budgeting. Before actually assuming management of a property and proceeding with your proposal, a management plan should be written which cites the owners' goals and objectives.

As an ongoing process while you are managing a property, test the impact of operating decisions against the stated goals to assure compatibility. When major decisions are required and before making a final decision, re-examine all goals and objectives with the owners to be sure that their goals have not changed and are still compatible. Also re-examine goals and objectives when factors influencing the operation of the property change.

Other Considerations for the Property Manager

The professional property manager is an agent of the owners. The only way to effectively perform in that capacity is to be sure each owner's goals and objectives are understood. If it turns out in practice that the goals are not realistic, the manager should try to persuade the owners to change the goals.

The only circumstance in which the manager is absolved of this responsibility is if the proposed owners' goals and objectives are immoral or illegal. If this is learned before assuming management, the property manager should not accept those owners as a clients. If it occurs later in the relationship, the property manager should attempt to persuade the owners to change their directives; failing that effort, the property manager should resign the account.

Forms of Ownership

Any business organization will have one of three primary forms of ownership:

1. Sole Proprietorship

2. Partnership

3. Corporation

There are variations of these three forms. These forms of ownership have an impact on property management.

Sole Proprietorship

Sole proprietorships are the oldest form of ownership. The business is owned and conducted by one person.

Advantages

1. Ease of formation

2. Lowest cost for organization

3. Flexibility of control. No one needs to be consulted, the business may enter into any lines, do anything legal, and there are no geographic restrictions.

4. Secrecy of affairs

5. Relative credit strength because of unlimited liability of the proprietor to creditors

6. Psychological value of the personal element, both in the effect on one's ego of running a business and in the personal nature of dealings with others

7. Ease of dissolution

Disadvantages

1. Difficulty of raising large amounts of capital in formation and in expansion

2. Absence of advice and assistance of co-owners

3. Unlimited personal liability of the proprietor for debts of the business

4. Lack of permanence. The business ends with the financial, mental, legal or physical demise of the proprietor.

Multiple Ownership

Under the multiple ownership form, two or more individuals have concurrent ownership of a property. This form of ownership is most commonly found in families, particularly married couples. There are two distinctive approaches to this form of ownership in some states.

Joint Tenancy

There is one title which cannot be divided, hence shares cannot be transferred or sold. Surviving owner(s) have the right to the decedent's interest (right of survivorship) regardless of the existence of a will and its stipulations regarding the balance of the estate.

Tenancy in Common

The title is held in the name of each owner and can be designated in unequal shares. As a result, the shares can be sold, mortgaged or given away. Because there is no right of survivorship, the share passes to beneficiaries with the rest of the estate, or to the party designated in the will.

Advantages

Expertise, abilities, and resources of the owners can be combined.

Disadvantages

Even though legally allowed, it may be very difficult to sell shares, particularly at their pro rata share of market value. This can create problems if an owner's goals, attitudes or financial capabilities change. Owners may not be able to work together successfully.

Partnerships

General Partnerships

This is the association of two or more persons to carry on, as co-owners, a legal business for profit. The partnership agreement may be either written or oral and usually deals with the amount of the investment, the sharing of profits and losses, new members, dissolution, duties of the partners, and the decision-making process. Insofar as third parties are concerned, each partner is a general agent of the business. In the absence of any stipulation, profits and losses are shared equally regardless of the amounts of the investment. Membership in the firm is transferable with the consent of the partners. A partnership sues and is sued in the names of the individual partners.

<u>Seniority of liabilities in a partnership is as follows:</u>

1. To creditors, other than partners. Creditors in turn may have their own special priorities as secured creditors. Taxes, for example, have priority over general creditors.

2. To partners for loans to the business

3. To partners with respect to capital

4. To partners with respect to profits

<u>Dissolution of partnership may be affected by:</u>

1. The terms of the partnership contract

2. Mutual agreement

3. Withdrawal of a partner

4. Bankruptcy or insolvency of a partner or the business

5. Death or insanity of a partner

6. Court decree

<u>Advantages</u>

1. Comparative ease of formation

2. Relative flexibility of control

3. Freedom of movement, since the Constitution of the United States

provides that the "Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States."

4. Psychological value of the personal element

5. Credit strength because of unlimited liability of the partners

Disadvantages

1. Divided authority

2. Unlimited liability of partners

3. Limited life

Limited Partnership

The limited partnership is a statutory device intended to protect one or more of the partners from the unlimited liability feature of general partnerships. It must have at least one general partner. Limited partners may have no voice in the management or control of the business. If the names of any of the limited partners are used in any way whatsoever, it must be made very clear that such partners are limited in their liability to creditors. If this requirement or any part of the limited partnership statute is violated in any way, the partners may be held liable for all the debts of the firm as if they were all general partners.

The limited liability feature of the partnership is good only in the states in which it has complied with the law regarding registration, etc. The limited partnership can sue and can be sued in its own name and also in the name(s) of the general partners.

Advantages

1. Relative flexibility of control

2. Limited liability of the limited partners

3. Relative credit strength because of unlimited liability of the general partners

Disadvantages

1. Divided authority when there are two or more general partners

2. Unlimited liability of the general partners

3. The limited liability of the limited partners also prevents them from having a voice in the management or control

4. The difficulty of restraining limited partners from involvement in control or management as well as meeting the other statutory requirements at all times

5. Limited life

6. Transferring interest may be a problem

Corporations

Although partnerships are the most common form of ownership, corporations account for the greater amount of business done. Corporations operate under a charter granted by the state.

As legal entities, corporations may sue and be sued in their own name. They have perpetual life until terminated through legal means. Transferable stock is held by shareholders, who enjoy limited liability to creditors. Directors are elected by the stockholders to administer the corporation's affairs. The corporation, however, must register in each "foreign" state in which it "does business;" otherwise it has no standing in such states.

The corporation is autonomous in the sense of organic independence of shareholders. It is this autonomy (legal entity) which makes possible the insulation of shareholders from corporate obligations.

Advantages

1. Limited liability of shareholders
2. Transferability and marketability of shares
3. Shareholders are not general agents of the business
4. Continuous life. The corporation does not end with the death of any individual: officer or stockholder.
5. Credit is strengthened by its continuous life which makes it possible for the corporation to issue long-term bonds and/or other forms of securities at favorable rates. The corporation retains this advantage without fear of termination so long as it remains solvent.
6. Ease of expansion

Disadvantages

1. Relatively complicated in formation and administration
2. Relatively high cost of formation and operation
3. Relative lack of freedom in movement
4. Ordinarily, lack of personal element
5. Credit weakened by limited liability of shareholders
6. Usually heavier taxation than in any other form of organization
7. Greater degree of governmental control than in any other form of organization
8. Complying with SEC regulations

General Terms

In most states, corporations are classified as municipal, stock and non-stock.

1. A <u>municipal</u> corporation concerns a territorial subdivision of a state, such as a county, town, city, village, school district, etc.

2. A <u>stock</u> corporation concerns a business organization which issues stock certificates to its shareholders, e.g., publicly traded or closely-held corporation.

3. A <u>non-stock</u> corporation is any corporation which is not a stock corporation. This term, however, is usually applied to ecclesiastical and charitable societies, fraternities, clubs, trade associations and professional societies, e.g., not-for-profit corporation.

4. <u>C Corporation</u> is known as any regular corporation that does not elect Subchapter S corporation status.

5. <u>S Corporation</u> is a combination of a regular Subchapter C corporation and a partnership. Like a corporation, it insulates shareholders from personal liability while ownership is easily transferred through stock certificates. Like a partnership, it is not a separate tax entity so all profits and losses are passed through to shareholders.

Relations to the State

Corporations may be classified as belonging to the public, quasi-public and private sectors.

1. A <u>public</u> corporation concerns a territorial subdivision of a state, e.g., schools, government offices, churches

2. A quasi-public corporation is a publicly controlled franchise to do business that is organized for profit.

3. A private corporation is one which is engaged in business, industry, or finance for profit, and not part of or controlled by the government. In this context, a private corporation can be closely-held or publicly-traded.

Purpose

Corporations are sometimes classified on the basis of their principal activity, such as railroad, public utility, industrial, financial, real estate, etc. These terms are self-explanatory.

Place of Incorporation

Legally, the location of the corporation's declaration determines its designation as being either domestic, foreign, or alien. These legal designations may be in conflict with terminolgy commonly used.

1. A domestic corporation is one which is incorporated in the state under consideration.

2. A foreign corporation is one which is incorporated in one of the other forty-nine states.

3. An alien corporation is one which is incorporated in another country.

Multiple Forms of Operation

Real Estate Investment Trusts (REITs)

This is a form of a trust which owns a portfolio of real estate and offers shares to investors. REITs are usually publicly held and traded via securities offerings.

Joint Venture

A business enterprise formed to carry out a specific project. It defines any combination of investors and may be set up in the form of a regular corporation or any other type of corporation, general partnership or limited partnership. Typically, investors in a joint venture contribute equally with either capital, expertise, or equity/debt financing.

Syndication

A group of investors who pool their capital in real estate property. The form of ownership is typically a partnership, but can take the form of an S or C corporation, unincorporated association or similar organization. Its purpose is to generate a large amount of capital by increasing the number of investors. Before the Tax Reform Act of 1986, syndications provided tax-sheltered-related real estate investments. Pursuant to the 1986 tax reform, syndicated investments are used for cash flow and appreciation benefits.

Condominiums

Individual ownership of office, residential or retail condominium units. Joint ownership of the common elements of property. This form of ownership has limited appeal in commercial ventures because of the restricted ability of the owners to expand and contract the space. Furthermore, it is very difficult to find a buyer with exactly the same needs.

Professionals with definite space needs such as lawyers and medical professionals sometimes choose this ownership form.

Cooperative Corporation

A form of real estate ownership whereby the property is owned by the cooperative corporation. Individuals can buy stock which entitles them to ownership in the corporation and a proprietary lease on a designated property unit or space which they may occupy. This form of ownership is theoretically available for commercial ventures, but is rarely used.