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PROPERTY MANAGEMENT FEES.
ARE MANAGERS UNDERSELLING THEMSELVES ?

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Introduction

Properties today, whether they produce a large net income or a small income, require professional property management by multi-skilled managers. These managers are expected to reduce outgoings, maintain rental levels, provide a high level of tenant services, and protect or increase the value of the asset. Owners are expecting (demanding) more and more services from property management firms. Simultaneously, the market, looking at ways to save money, and with pressure from increased competition, is forcing fees downward. To counteract this property managers, and the firms they work for, need to understand and monitor their cost base.

Preliminary research has found many firms that offer a diverse range of management services have never determined how much it actually costs to provide these.

Computing Fees.

The methods that can be adopted to compute property management fees are no different to those used to calculate a charge for any service or product. The crucial thing is to determine an accurate overhead cost and allow for an adequate profit. There are several ways that can be used to set, or charge out property management fees:

Income Based. The management fees are based on a fixed or sliding scale percentage, of the collected income. There is a major problem with this, (that many property managers never see), in that the management fee may be in no way related to the actual cost of management. This can be true during periods of high vacancy. (Small income = small management fees). Many owners prefer this method as they feel that the property manager will be motivated to increase income to increase fees. There may be a different amount of time required to manage different types of buildings, and fees may not be in alignment with the difficulty of the job.

Per Square Meter Basis. This method is not often used, however it does hold favor with owners as the fee for managing a large commercial building with only a couple of quality tenants could be far less than managing a smaller building with a multitude of tenants, a percentage of whom may be poor rent payers. There may be a case for using this method in retail premises, as the amount of net lettable area, and keeping it fully leased and operating properly, are in direct relation.

Flat Fee Basis. This approach is becoming more popular with both property managers and owners. If this type of fee is calculated properly, a flat fee can actually take into account, the complexity of the building operation, cost of actual time spent performing management functions, the condition of the building, the quality of the existing tenants, the amount of vacant space, and if the building is new, the additional costs involved in setting up the necessary systems to get everything running.

Loss Leader. A fully integrated service company may offer to undertake management for a reduced fee to get the leasing work, possibly obtain selling rights, or even valuation fees, and then these, supposedly, subsidise the management fee. There is also the scenario that fees may be reduced, to acquire a management, (entice a new client to the firm), but the logical outcome is a reduction in the level of service. These lower fees may seem attractive to owners, but the cost of management is small when compared to the savings that can be achieved by skilled managers. (Shearer, 1993, P.50).

Costing out management fees.
The following factors must be considered when calculating/estimating the costs to manage a particular premises.

- Study the tenancy schedule for the number and type of tenants. This will give an indication as to time needed to handle communications and the problems that may occur.
- If previous years figures (especially monthly financial statements) are available, they must be examined closely as they could reveal rental arrears, lack of repairs etc. Again this helps in estimating time needed to solve problems.
- A full inspection of the building must be carried out to determine its physical condition. A building in poor condition will require an allowance for additional time for major repairs/refurbishment etc.
- Determine the owners' financial reporting requirements. This would include the frequency and detail of reports.
- Study the owners' goals and objectives. Are these compatible with the capabilities and structure of your department/firm ? Are more or specialised staff needed to meet these goals ?
- Review the cost of existing personnel, is it up-to-date ? Calculate the amount of time necessary to operate the building.
- Investigate to see if there are operating, emergency and other manuals in existence. If not an allowance will have to be made to create them.
- Estimate what improvements should be made to increase the owners' net income. Access to previous years figures is essential to carry this out.

From this it can be seen that some of the costs are direct and some are indirect.
The direct costs, which are usually in the majority, are all the costs incurred by the actual property manager and property management department/division.
Indirect costs could be incurred when property management departments share facilities and expenses with other departments/divisions of the company. These could amount to some 25% of the total costs of operating, but they are less visible and tend to be overlooked. A proportionate share (or allowance) for rental (occupation costs), general office overheads, (general receptionist, word processor operators etc.), and accounting services, (preparation of financial and other reports as required by the owner), should be allowed for when costing fees. Naturally the hourly rate for these should be less than those for direct costs.
If a management proposal is being formulated for a new building, extra time may be required to set up all the management systems, procedures and manuals. This cost can be amortized over the length of the management contract. Many owners do not realise that by letting out a short management contract, (1 or 2 years) for a new building, they are forcing the management company to recoup their set-up costs quickly. A minimum, mutually beneficial contract period would be 3 years, as the first 12 to 18 months are usually not profitable.

Staffing
Estimating the staff required to undertake management of a building or portfolio is crucial in calculating the fee. The clients a property manager may have to deal with can range from large institutional investors to single owners. They all feel that they should have the same quantity of time input and quality of service. They will have

different goals and objectives, and therefore require a variety of operations, financial reporting and management skill, that only trained personnel can meet.
The person costing the fee must ensure that, not only are the staff available and qualified, but that the necessary systems are in place, or can be developed to economically manage the property. (Still maintaining an adequate profit margin).
With the increased sophistication of building operations, it may be necessary to sub-contract specialist areas of building maintenance. This means that a property manager or property management firm must know their limitations and call in experts to quote or tender for some procedures. E.g. Facilities managers for plant & equipment.
The property manager must therefore be in a position to assemble a team of professionals who have the expertise and whose costs can be spread over a number of properties.
If rents remain static or fall the only way to maintain building income is to increase building efficiency (decrease outgoings), which places more demands on the property managers’ time. An allowance must be made for this.

Assessing the Request For Management.
One of the factors used to determine the management fees, will be the owner’s requirements, as detailed in the request for management. (RFM). When an RFM is received, it must be analysed carefully to determine what is required. Many times an RFM is verbal, or in a simple letter form, containing insufficient details to allow for the preparation of an accurate costing. It may be necessary to prepare a set of questions for the owner for more specific details, before submitting a tender/bid.
“Thinking like an owner is essential for the successful property manager”. (Campbell. 1992. P49.) Therefore the property manager must ask questions, to enable proper strategies to be formulated/planned. Owners may not be forthcoming with the information, (many are unaware of what is required to assess management fees), but it is up to the property manager to probe for what is required. Campbell goes on to state that “…sometimes there is fear and hesitation, and managers are afraid that if they ask too many questions they’ll lose the business. Actually the opposite is true.” Showing the prospective client that you really do know what you are talking about may win the management contract. “To bid effectively, a determination must be made of exactly what is required and exactly what these requirements will cost”. (Shearer. 1993. P. 51).

Computing Time Allowances
The amount of time that needs to spent carrying out and supervising day to day operations has to be calculated. If there is no on-site manager, then a greater workload will come back to the property manager. (This must be translated into a time equivalent).
To estimate this, a ‘Management Pricing’ worksheet, needs to be used. (See sample pricing sheet annexed to this article. Adapted from Kyle & Kennehan. 1979.). What needs to be allowed for in pricing should be detailed in a logical order, but allocated back to the staff that will be involved. For example you might have an executive property manager who supervises a number of property managers, who in turn supervise on-site managers. There must be an allowance for the use of clerical and accounting services, as well as a figure for overhead and profit.

The pricing worksheet should also allow for site inspections, regular meetings, contingency (emergency) visits. Travel time, office time and vehicle expenses must also be taken into account. Naturally, a common denominator should be used to calculate the costings, and this is total hours per month. The cost can then be calculated at different rates for the parties involved with the management. For example, the executive property manager charge rate will be higher than that of the property manager, but the property manager will have a greater number hours involvement with the management process.
When the final monthly management fee is computed, it should then be compared with others already charged by the company (try comparison on a percentage to gross collectable income), and also to known industry benchmarks. If the fee appears to be out of line, (uncompetitive, either too high or too low) review should take place or the business could be lost.
This review should look for errors, or areas included that may not be necessary in this particular management scenario. The temptation is to cut back on either necessary management services, or lower the charge rates. The fees you calculate must cover costs and allow for a reasonable profit margin. There should be a policy in place to review management fees annually, (even those under a fixed price/term contract) to isolate those that can be raised. Properties that are causing problems, consuming an inordinate amount of time, without producing enough (or any) profit must also be identified. The owners of these non-profit managements must either be approached for immediate fee increases, or the management terminated.

Areas Often Overlooked When Pricing.
As stated previously in the article an inspection of the building must be carried out prior to taking on management. Do you allow for this in your pricing, or is it just a part of the overall office cost in running a business ? What systems are in existence to maintain and control the building and plant ? (Preventive maintenance, operating manuals etc.). Has an energy audit been carried out recently ? How long since contracts have been reviewed for building services ? Is there a management plan in place, or does a new one have to be developed from scratch ? (A definite time allowance would to be made for this).
Some questions rarely asked by property managers when they are approached to take over management is, “Why is the owner changing or contemplating changing managers ?”, and “Why or how did they find out about your firm ?”. This may give an insight into the areas where the owner is dissatisfied. It may also show you that the owner is unreasonable and it is better not to waste time quoting on the business.
Time must be allocated to search and read leases and create a comprehensive tenancy schedule. This will have to be imputed then analysed to allow for the billing workload to be calculated. This cost may arise from the accounting and clerical services area, but if the building is a multi-tenant situation then the costs will be greater. The type of financial reporting that the owner is using must be examined to determine if it can be carried out with your existing system. The quantity, detail and frequency of reports required must also be investigated, as many times the owners, and their representatives, are unaware of what they really need. Many owners with large cash flows require draw downs on a weekly or two weekly basis, rather than monthly. Can you accommodate this in your system ?
If the building has any vacancies, this must be taken into account. The leasing and tenant retention strategies should be reviewed and analysed for performance. This

may involve the creation of a new leasing plan, with time allocated to structure it, implement and run it.

Under the heading, Computing Time Allowances, emphasis was given to using hours and total hours per months as common denominators. The same applies to these areas that are often overlooked. There may be the opportunity to amortize these extra costs over the period of the management, (build-in extra hours over the whole period, or request an initial set-up fee, then bring the costs back to a reasonable monthly amount). Research has shown that most owners appear to accept the amortization process, rather than an initial set-up cost.

Conclusion

However the fee is calculated, it must be carried on the basis of actual costs, plus overheads and a definite allowance for profit. It is realised that in the marketplace many property management departments come under pressure from the 'glamour' departments of selling and leasing, to make concessions on fees. This may have been acceptable practice in the past, but as the degree of skill for property managers increases, so must their rewards. If concessions are made on property management fees, to please other departments, there must be a reward (bonus) system in place, so that part of the selling or leasing commissions, flow back to the workers at the coal face.

Some managers have set fees low, without an understanding of management costs. This can make it easy to attract business, but if fees do not cover your costs, with an allowance for an adequate profit margin, then you will quickly find your property management department has managed itself out of business.

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