

“Becoming a Landlord”
Basic Real Estate Negotiation

William

General Background:

Olivia and her brother William recently decided to enter into the business of commercial real estate. Their father had left them a \$100,000 inheritance to split 50-50 and had told them both that they should invest it in commercial property. They purchased a small strip mall together with solid, stable tenants and had hoped to sell the property at a profit in five to ten years.

While there is no formal agreement, the basic understanding had been that Olivia would put up the additional money necessary for the down payment, and William would find the property and manage it. Olivia lives in New York, while William lives in San Diego.

William's good friend Sonia is a local commercial real estate agent in the San Diego area. Sonia agreed to help identify possible properties and handle everything through the purchase of the property by Olivia and William for a 5% commission of the sales price (to be split between the sellers and buyers, so that Olivia and William would owe her 2.5%).

Sonia found an ideal strip mall that was for sale at \$1 million dollars (significantly below market rates according to Sonia), and it was not too far from William's home. All of the units were rented by stable businesses with multi-year leases. Some of the tenants were a little demanding over the last few years, however, concerning repairs and maintenance issues.

The opportunity was so good that Olivia and William decided to go ahead with the venture, and Olivia put in \$100,000 of her own money for a total down payment of \$200,000 (Olivia's \$100K plus the combined \$100K inheritance). Olivia also signed a mortgage to borrow \$800,000 to cover the remaining payment for the property. In addition, Olivia had to pay Sonia's commission of \$25,000 and also \$10,000 in various initial expenses and other minor costs.

The building earns about \$75,000 per year. Mortgage payments and other expenses add up to about \$75,000 per year, depending on any additional repairs.

After signing the agreement and taking ownership of the property, Olivia and William realized that they had not yet agreed on what compensation William would receive for managing the property. They had talked about an arrangement where Olivia has 75% ownership and William has 25% ownership of the property. Olivia is in San Diego this morning on other business, and the two have set up a meeting to figure out the details of William's compensation.

Inside Information for William:

You are an extremely organized person and a good manager of people generally. You will be a very effective manager of the property, but you are not interested in doing it for charity. You expect to be compensated by getting a growing chunk of the pie.

You have talked with Sonia about what might be appropriate for your services, and she says that you should definitely get an additional ownership interest in the property, and that the percentage should increase over time (as you continue to provide management services each year). You asked her if it was out of the question if you received something like a 2% bump in ownership of the property each year (on top of your initial 25% stake), and she said that was "totally fair." At the end of your conversation right before she took another call, she also mentioned you that you might want to propose some sort of salary.

Besides, this whole opportunity arose because of you. If it were not for your friendship with Sonia, and your legwork in finding the right property (while Olivia was making big bucks in NY), Olivia would have 75% of nothing.

Even more, managing the property is no picnic. You have had to hire maintenance and grounds crew workers. And you had to organize all of the lease information and deal with the termite infestation in the backyard. Also, you already have had to deal with repair issues in two of the businesses (hiring outside help) and you can just tell that a few of the tenants are real squeaky wheels.

While you are open to different options, you have been thinking a lot about an escalating percentage of ownership over time, and maybe even a kicker upon the sale (since you will probably be the one who handles that process with Sonia as well). You are very eager to explain to Olivia your point of view. Do everything you can to take charge of the negotiations from the beginning - even consider making an opening proposal.

As preparation, make sure to put together your arguments on why you feel that you deserve additional compensation. Think about what exact compensation you should propose. Your cash flow, for example, has been pretty tricky these past few months, since you lost your full-time job at the video store and have had to take on the part-time dishwasher gig in La Jolla.