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## Negotiating Management Contracts

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### 1. Who can manage a community association?

- Direct employee of association can perform administrative, financial and management duties
- CPA or bookkeeper can manage accounts payable and receivable as part of their normal accounting services
- Independent person or company contracting with an Association for professional management of the property for any compensation or fee (including waiver of assessments) must have Real Estate Broker's license or be associated with a licensed broker
- Conflict of Interest created when a current member of the Association or someone with a financial interest in one or more units is acting as association manager

### 2. What are some things to consider when selecting a management company?

There are many different types of management companies, ranging from 1 or 2 persons working out of their home all the way up to national companies with offices in every state. There are also many different types of services provided by management companies. Here are some red flags and things to look out for when selecting a management company:

- Before interviewing management companies, boards should put together an RFP and list the items that are important to them and questions that they have about the management companies, how they operate, who performs what functions and how they charge for different services. It is also important to know what credentials a management company has (including licensing and any certifications from any trade organizations), as well as the experience and credentials of the individual manager(s). Boards should also have a good idea as to how much control they want the management company to have over the Association's finances,

maintenance, etc. vs. how much control the board wants to maintain. Boards should also determine whether they are looking for full management services, financial management only, or something in between. This will better help them identify which management companies will be a better fit for the Association's particular needs. It is also a good idea to get referrals and input from other associations or other professionals who have dealt with various management companies.

- Larger management companies often have affiliated businesses that are owned by the management company or owned by the same person or people that own the management company. These can be maintenance companies or contractors, collection agencies, or other vendors with whom the management company is hoping that the association will do business. Management companies should disclose any affiliated business relationships and advise the association that it is not required to use any of the affiliated businesses. Failure to disclose any affiliated businesses or a policy requiring the association to use any of the affiliated businesses should be a red flag.
- In addition to or instead of having affiliated businesses, some management companies have preferred vendors for different services. They may have established some sort of negotiated discount with said vendor or may simply have had a good experience working with the vendor in the past and feel good about referring their services. If the management company receives any financial incentive for referring an association to a vendor, that is a red flag. Also, management companies that require their associations to use their preferred vendor(s) and do not allow the association to keep its own vendors or to contract with new ones outside of the preferred list should raise concerns for any board who is interested in maintaining some level of control over the vendor selection process.
- There is a fairly high turnover rate with managers and management companies, so boards need to understand that the person who is currently acting as their manager may not always be in that position or with that company. The board should be permitted to meet with and interview the person who will actually be managing the association before signing a contract and should also be allowed some input in the selection of future managers should that become necessary to make a change for any reason. This will help ensure that the manager is a good fit for the particular association and vice versa.
- Don't be fooled into believing that standard contracts produced by management companies are not negotiable or that all contracts are the same. If your selected company won't negotiate the contract terms that are of concern to you, you might want to consider finding another management company. Don't be afraid to ask questions about any contract terms or provisions that you do not understand or that seem ambiguous. If a company is unwilling to put certain terms in writing or responds in a manner that appears evasive, inflexible or dismissive of the board,

that may be a red flag that this person or company may be difficult to work with and/or that the Association is not getting the best value for its money. It goes without saying that you should always have your association attorney review any major contracts before signing them.

**3. What are some common provisions in management contracts that we should be aware of?**

- Management contracts will typically be for a set period of time (1 year, 2 years, etc.) and then have provisions for renewing the agreement for additional time periods. They also contain provisions regarding whether and how either party may terminate the agreement before the end date. Many associations have provisions in their governing documents that place limitations on the terms that the Association can have in a management contract. This includes limitations on the length of the contract as well as provisions requiring that the agreement be terminable by either party without penalty without cause upon at least 60 or 90 days' notice and for cause upon 30 days' notice. A board does not have authority to enter into a contract containing provisions that conflict with any such requirements contained in the association's governing documents, but many management companies will try to lock the association into longer terms and/or make it so that they cannot get out early or have to pay a penalty to do so. They may also contain provisions that permit the management company to terminate the contract on short notice (less than 30 days) under certain circumstances if the Association does certain things or fails to pay the management company. However, these too would conflict with these limitations that are often found in an association's declarations or bylaws.
- Management contracts also often contain an auto-renew clause that states that the contract automatically renews for a successive term unless either party notifies the other of its intention not to renew by a certain date. This could conflict with the Association's governing documents and can also be problematic when there is periodic changeover in the board and the new directors don't know enough to send the required notice in time.
- A management contract should spell out what the management company will do and what services it will provide for the regular management fee. This includes accounting support, attendance at meetings, sending out notices and mailings, handling violation notices, coordinating with vendors and responding to maintenance requests, obtaining bids, etc. It should also clearly spell out what services are not included in the regular fee and whether they are available for an extra charge (and if so, how that charge will be calculated). If the management company will host a website for the association, the agreement should also spell out what content will be put on the website, who owns the content and the

website, and who has administrative rights to make changes or post items on the website.

- If the Association will have on-site employees that will be employed through the management company, the management agreement should spell out that relationship, making it clear that the employees are employed by and paid by the management company and that the management company has the ultimate say in hiring, firing and compensation matters but giving the association the right to have input into and approve employees and employee compensation that the association will be reimbursing to the management company.
- If the management company will be coordinating the association's insurance policies and keeping those policies up to date, the management agreement should include a requirement that the management company provide the board with reasonable advance notice of the termination date of any policies as well as any notices of termination or non-renewal that it receives so that the board has sufficient time to shop for other policies.
- If the management company will be assisting the board in preparing annual budgets, the agreement should provide deadlines by which the manager must have a draft to the board for review so that the final budget can be approved and adopted sufficiently in advance of the start of the next fiscal year. The agreement should also contain provisions regarding the compilation of the annual financial statements and reports so that they can be provided to the association's CPA in a timely manner for the annual review or audit.
- It is important that the management agreement appropriately provide authority for the manager to handle small and/or emergency repair requests without having to get bids and/or approval from the board while also limiting their authority to spend the Association's money without approval. Many management agreements contain a spending cap that allows the manager to spend up to a certain dollar amount per non-emergency occurrence without having to get a vote of the board and allows the manager to do what is necessary to deal with an emergency. Boards will want to review these spending limits to ensure that the limit is set at an appropriate amount and that it does not give the management company carte blanche to pay itself or its affiliated companies large sums (albeit in small increments) without board approval.
- Boards desiring to maintain control over the vendor selection process will want to ensure that the management contract provides adequate protections in the form of requiring the manager to obtain a certain (reasonable) number of bids for larger projects and ensuring that the board must approve of all vendors selected before a contract can be signed or work given to a vendor to do. It should also require that all contracts with vendors be signed on behalf of the association by a board member (NOT the manager). Smart vendors will require this as well.

- Boards should understand the collection processes in place by the management company and ensure that the contract adequately reflects how the association expects that to be handled. Does the contract give the manager authority to make decisions without consulting the board? If so, what authority does the manager have and what limitations are placed on it? Management contracts that provide for a fee to be charged by the management company for actions that would be deemed to be the practice of law (or unauthorized practice of law if done by a non-attorney) such as filing lien statements or sending other legal notices should raise red flags. Other red flags to look out for are management companies that have their own in-house attorney or collection agency to handle collections for association clients. If the attorney is an employee of the management company, that raises serious conflict of interest issues in having that attorney then representing the Association in any legal matter. Arrangements where the attorney has a separate law firm (that may be captive to the management company) or works for a collection agency that just happens to be owned by or an affiliate of the management company may pass muster with the legal ethics board but should still be looked at carefully to determine whether a conflict exists that would prevent the association from getting the best representation. Further, a collection agency that does not have an attorney working with it will be limited in the services that it can provide to an association, so the association should have the option to seek outside counsel of its choosing when necessary and not be billed twice.
- Older management agreements often contained provisions that allowed the management company to essentially act as an insurance adjuster in assisting associations with large insurance claims and to be paid a percentage of the insurance proceeds for doing so. However, the Department of Commerce has made it clear that a public adjuster's license is required in order to be compensated for providing adjuster services and has been cracking down on this and fining management companies who are doing this without a license. Unless someone associated with the management company has a public adjuster's license (ask to see it), the contract should not contain this language anymore. Administrative fees for coordinating work or repairs on a big project may be allowed – have your attorney review the exact language.
- Many management companies consider resale disclosure fees to be an additional source of revenue with them and will write into their contract that they will charge and collect the fees for completing these directly from the owner that is selling or refinancing their unit. However, the Minnesota Common Interest Ownership Act (“MCIOA”) only provides authority for the Association to charge an owner for these fees. There is no statutory basis for a management company to charge an owner for these fees. Management agreements should provide that the management company will charge the fee to the Association. The Association can then pass that fee onto the owner. Management companies are usually hesitant to change this language in their contract, but it is they who are at risk of

not being able to collect their fees if challenged, so it would be to their benefit to structure these transactions correctly.

- Some management contracts will contain additional fees that will be charged to an association (and usually passed on to the applicable owner) in certain circumstances when the manager has to do extra work or go above and beyond what is normally expected of him/her. Examples of this might be an administrative fee for processing information and forms for rental properties, dealing with insurance claims, dealing with vacant and/or foreclosed properties, etc. They may also charge an administrative fee for processing manual payments for owners that do not have their accounts set up on ACH. Boards should be aware of these additional fees and check their governing documents to see if the Association can pass any of these charges onto the owners. Also, if the Association has such an administrative fee that it has been charging owners under its existing management contract (or that it would like to start charging), the board will want to make sure that this charge is written into the new contract to ensure that it can continue to be assessed back to the owners as an actual expense.
- Management contracts will typically include provisions that limit the management company's liability and require the association to indemnify it against claims that may be brought as the result of the management company acting as the agent for the association. Associations should have their attorneys review these provisions carefully to ensure that the limitation on liability is appropriate (i.e. will the management company be liable for its criminal or intentional acts? What about gross negligence, or ordinary negligence?). Often, the management company will try to limit the amount of time that an association can bring claims by including provisions that reduce the statute of limitations and/or require written notice of a claim to be provided within a very short time frame or a claim is waived. The agreement may also include a liquidated damages clause that limits the amount of money that the management company will have pay out under a claim regardless of the amount of actual damages to the association. Again, these provisions should be reviewed carefully by an attorney and possibly negotiated to something that is fairer to the association.

**4. What can we do if we are having problems with our management company? How do we get out of our contract?**

- Before terminating an agreement and going through the process of transitioning everything to a new management company, boards should consider meeting with the manager and/or the principals of the management company to discuss their concerns. Perhaps a changeover in the board at an upcoming annual meeting may help smooth things over, or maybe the management company can assign a different manager whose personality and/or management style will be a better fit for the association. If the board feels that the manager is providing it with bad advice, the board should consider seeking

outside advice from its attorney, accountant, etc. (this should be done anyway). Maybe it is the board that needs training on its responsibilities and/or how to conduct meetings.

- If the relationship cannot be salvaged and the management agreement is properly drafted with an appropriate termination clause (see above), then the Association can provide proper written notice to the management company of its intent to terminate the agreement as of the appropriate date. The parties will continue to be bound by the agreement through the termination date, but oftentimes the existing management company will assist the Association in an earlier transition to a new management company to help ensure that the new company is in place and ready to go at the start of its contract. If the management agreement does not contain the appropriate termination clause, but the Association's governing documents require the agreement to be terminable without penalty upon certain notice, the board may be able to use this to "rewrite" the agreement to conform to the Association's governing documents and thus allow for an easy termination with proper notice.
- If the management agreement does not provide for early termination without cause and without penalty and the Association's governing documents do not contain language requiring these restrictions on the management agreement, then the Association may be bound by the existing contract language and may have to wait out the remainder of the contract term and/or pay an early termination fee. If the agreement does allow for termination for cause, then the Association will want to consult with its attorney regarding what does and does not constitute good cause for termination and what obligations the Association may have under the agreement before it can terminate it for cause.
- Oftentimes, when a management relationship is not going well, it is not just the board that is feeling the tension. The management company may very well agree to terminate the relationship early even if the contract does not otherwise provide for this, so it does not hurt to ask or to try to negotiate an amicable exit.