



Breakout Session
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The Risks When a Residential Agent Manages Commercial Real Estate



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Risks When a Residential Agent Manages a Commercial Property

Good morning Ladies and Gentlemen! Let me introduce myself, I am Steven Sofos, President and CEO of Sofos Realty Corporation, Hawaii's 3rd largest commercial real estate and property management firm. I also will be the 2012 President of IREM Hawaii, and was the past president in 2009 as well. **I enjoyed it so much, I came back for seconds!**

Sofos Realty handles over 7+ million square feet of commercial properties throughout the State of Hawaii and does over 450 lease and sales transactions per year. Some of the lease transactions are as small as 100 square feet and some as large as 150,000 square feet.

The biggest problem I have seen in residential agents managing commercial properties is **financial accountability**, meaning commercial properties are governed by a written lease that was negotiated between landlord and tenant. These lease documents are typically 40+ pages and contain all of the terms and conditions whereby a tenant will occupy a space.

Most residential agents feel they can use **Quick books** or **Quicken** or an **excel** spreadsheet. Those programs are great for a small property of 1-5 tenants, but for larger properties they lack the detail needed. Secondly, most agents don't have an idea of a **chart of accounts**, which details all of the potential and actual costs associated with a property. Also, a good property manager will create an **annual budget** to estimate what the costs and expenses will be for the calendar or fiscal year.

Third, the agents **never read the lease** to understand what it contains. Some have no idea as what **estoppel**, or **attornment** provisions are, or **insurance** provisions in a lease are required of the property owner and the tenants. Some Realtors do not understand the legal terms and thus are not aware of what is in a Lease. This is a serious cause of litigation.

BOMA has a great booklet called Office Buildings: Standard Methods of Measurement. You should order this on line as it gives details on how square footage is computed on commercial buildings. Although the book says office buildings, it also applies to retail spaces and warehouses. For instance, the square footage often goes out to the middle of the window and in retail it goes to the back wall and 2/12" to 3" on the sides. So in other words tenants and some property managers measure the interior wall and many arguments have gone on over measurements of space. Also, learn the terms what Load or core factor is, rentable vs usable square footage.

Tenant Delinquencies are an area that most residential people are not well versed. The lease document dictates what rights the landlord and tenant have in a lease and also talks about default. In the commercial market, we send notices of default and call and go see the tenant. If no payment, my company has taken a zero tolerance. In that they are sent to legal. That process usually takes 60 days to evict the tenant or negotiate a payment plan. One of the favorite things we do is to obtain a **stipulated judgment**. That is a document that says if a tenant misses one payment on the workout, the landlord can go to court and automatically evict the tenant without having to go to trial.

Another issue is repairs and maintenance. Too many times we have seen Realtors hire their friend who is not a licensed or bonded contractor, and as a result, the work is shoddy, the contractor takes too long to do the work or never shows up. There are many good businesses who do good work. We obtain a minimum of 3 bids before doing any work. We do not hire handy men. I am sure some of them are good and reputable but we cannot risk the repairs back firing and the landlord sues the broker and the contractor. People if this ever happens to you, it will be a very expensive lesson that you will not ever forget. The same goes for maintenance of properties. We hire reputable landscapers, plumber, roof inspectors, and engineers and architects. These people are professionals. They have years of being in business and are licensed and have insurance.

Now I will switch gears to talk about the commercial real estate market in Hawaii.

The overall commercial real estate market is poor in Hawaii and will continue to be that way for the next 2-3 years. Office vacancies will continue to decline, retail space is struggling, and the majority of industrial space is based on the construction industry related uses such as tile, carpet, counters, cabinet, plumbers, electricians, and other types of business, which are having their problems. The Hawaii State Legislator did not help business this go round in 2011, as they tried to destroy the construction industry with GET exemptions. This will also hurt your industry, as fewer homes will be built over the next 2+ years as the GET pyramiding will cause higher prices of homes and condos.

You may not realize but the majority of the legislators have been in office since the mid 1970's! Maybe it is time for some new blood. The legislature has done a pretty job good of screwing up the Hawaii economy. Everything has been done to further the government employee unions and the attitude in the state is that we in private industry work to pay for the government workers, when it should be the other way around.

I wish also to talk about The **Commercial DROA and Purchase and Sale Agreement** that the Board of Realtors and CCIM came up with a few years ago. I don't like the form, it is a recipe for disaster and lawsuits in my opinion. Normally in a commercial real estate transaction, the broker draws up an **Letter of Intent**

("LOI") which is 4 to 10 page document that was created by the attorney for the Broker/Company. The document is non binding. Then the buyer or Seller's attorney, draws up a **Purchase and Sale Agreement ("PSA")** which is negotiated between the parties and is normally about 20-40 pages and very detailed. There is usually a due diligence period whereby the buyer hires consultants; architects, engineers, and other professionals to inspect the property. Sometimes a phase I and II environmental report is ordered. The Seller gives the buyer all documents it has on the property for the buyer's review. At the end of due diligence, the buyer then accepts or rejects the property. What we like is that when the attorneys draft a PSA, the two attorneys in essence say "brokers, you did your part, now get out of the way and let us do our part. That way, there is less chance of litigation whereby the broker gets sued. For a cost of around \$5,000-\$10,000 depending on the size of the transaction for a Seller or Buyer, it eliminates a lot of potential litigation. And you all know who gets sued when there is a dispute, THE AGENT! You agents may not have done anything wrong, but when attorneys file lawsuits, the shoot at every moving target, especially agents.

In the residential market, when I started, the DROA was 1 page and now it is 14 pages and growing. Why, "misrepresentation and litigation". I still have trouble with the buyer's disclosure statement in DROA's. All it is a list of **"I don't know"**, by Sellers.

We as Realtors are independent thinkers and workers. As one of my attorneys says **"if you don't kill, you don't eat"!** **So Play safe out there and when in doubt take the conservative approach.**