

Congratulations, You're a Landlord – Now What?

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So you took our advice ("Prudent bidding on real estate at a foreclosure sale" – http://wraltechwire.com/business/tech_wire/news/blogpost/7334076/). You found residential rental property in foreclosure and you invested. What's next? Some recent changes in residential landlord-tenant law have made it more important than ever to know just what you have gotten into.

Residential Versus Commercial Rental Property

In North Carolina, commercial landlords and tenants are presumed to know their business, and so the law takes a "hands-off" approach and lets the parties write their own terms, wise or foolish. This is not so in the residential rental context where the law takes a much more paternalistic role. This article touches on matters important to a residential landlord.

Minimum Requirements

To start with, you need to know the basics. In North Carolina, "the basics" are found in Chapter 42 of the North Carolina General Statutes, sometimes called the "Landlord-Tenant Act" ("Act"). Only after you familiarize yourself with the requirements placed on residential landlords in North Carolina by the Act should you begin looking for a tenant.

Among other things, the Act requires a landlord to:

- Do whatever is necessary to provide the tenant with fit and habitable premises;
- Maintain all plumbing and electrical systems, heating and air conditioning units, appliances, and other facilities in good working order;
- Keep the tenant's security deposit in a segregated account separate from the landlord's money and unavailable to the landlord except for certain rental-related purposes;
- Return the tenant's security deposit within 30 days after termination of the tenancy, unless it is used to pay for damages, unpaid rent, or unpaid utilities; and,
- Not charge a late payment fee in excess of \$15 or 5% of the monthly rent, whichever is greater.

If you are satisfied that you are prepared in all respects, financially and otherwise, to take on these obligations, it is time to find a tenant and get that income stream started.

Finding Tenants

There is no science to finding tenants. In addition to the traditional outlets such as using real estate brokers and advertising in local newspapers and bulletin boards, the Internet and websites like Craigslist have become

valuable tools for finding potential tenants. But regardless of how you find them, you need to put your potential tenants through a thorough screening process to ensure you are getting high-quality tenants who will pay on time and take good care of your property. A credit check is essential, as is a written application that includes a rental history, references, and questions about foreclosures, bankruptcies, and previous evictions. Study and follow-up on the information you obtain and do not risk months of misery just to fill a vacancy quickly.

A Good Lease Form

Unless you intend to lease your property to the same tenant for more than three years, a written lease agreement is not required. However, without a written lease agreement in place, you are setting yourself up for a lengthy and costly "he said, she said" battle where courts and juries sometimes view you as the mean old landlord and your tenant as a suffering angel.

Additionally, although you cannot contract away the rights afforded to tenants under the Act, you can clarify each party's rights and responsibilities with a well-written lease. Who will maintain the lawn? What happens if the roof leaks? Does either party want the right to terminate the lease early under certain circumstances and, if so, how much notice is required and what will the penalty be? Who pays the taxes and insurance on the property? Are any pets allowed? How many people can occupy the property, and do they have to be related by blood or marriage? These and many other items are all issues that need to be considered and addressed in your lease agreement.

Property Management Company

Do you want to own rental property but without the potential headaches that come with dealing with late payments, ensuring the property is fit and habitable, and responding to late-night calls regarding leaks and the fact the toilet is backed up? You can have the best of both worlds, but you will have pay for it.

Property management companies can make a landlord's life much easier and they are not difficult to find – most local real estate broker offices have one or more agents on staff who deal in the property management arena. Simply ask around for a referral from other landlords you may know.

Property managers are generally paid out of the monthly rent payment – expect to pay around 10% of your rent to the manager. That percentage can buy you a lot of peace of mind, as the manager will take care of all the potential hassles that come with rental property ownership, including getting the plumber to the property to unclog the toilet (and, by the way, your written lease agreement can provide that your tenant pays the plumber's bill if it turns out that the clog resulted from an "unexplained" flushing of a stuffed rabbit or other inappropriate article), and, more importantly, evicting your tenant if and when the relationship goes south.

Property management companies can also help you screen your potential tenants to lessen the risk of having to resort to the court system to evict a deadbeat tenant. As you expand your stable of rental properties, you will certainly want to give strong consideration to hiring a reputable property manager to help you keep your wits about you.

Of course, you should examine your proposed property management agreement carefully and make sure you are certain of each party's responsibilities.

Ownership Considerations

There is nothing wrong with owning your rental property in your individual name. You most likely will have liability insurance attached to your casualty insurance policy to cover any potential loss you may face arising

out of incidents or accidents occurring on the property. However, owning a rental property comes with a lot of potential liability (slips and falls, your tenant's dog bites a neighbor, etc.), and having another layer of protection never hurts. Many landlords prefer to create limited liability companies ("LLCs") in which to take title to their rental properties, and many put each separate property into a separate LLC.

Recent Laws Affecting Landlords

Regardless of how you get your tenant, whether or not you hire a property manager, or whether or not you create an LLC to hold title to the property, some recent laws have increased the burden on residential landlords in North Carolina:

Carbon monoxide detectors: Language recently added to the "fit premises" provisions of the Act requires landlords to install one operable carbon monoxide detector on each level of a dwelling that has a fossil-fuel burning heater, appliance, or fireplace. The detectors may be either battery-powered or hard-wired and must be checked by the landlord (or the landlord's property manager) at the beginning of each new tenancy. Thereafter, if the detector is battery-operated, the burden is on the tenant to replace the battery as needed, unless the landlord and tenant agree otherwise. The landlord is required to replace the detector within 15 days after notice from the tenant that it is not functioning.

1099 reporting requirements: A provision of the federal Small Business Jobs Act of 2010, effective January 1, 2011, requires a landlord to issue an IRS Form 1099 to any service provider to whom the landlord pays more than \$600 per year. That requirement applied previously only to landlords with enough rental properties to put them in the "trade or business" category. Now, the owner of a single rental property must comply with the reporting requirement. This could ratchet up the paperwork significantly for a landlord who hires the occasional plumber, handy-man, landscaper, or other service provider. Care will need to be taken to obtain the necessary information from these providers to complete the form (including name, address, and social security number or tax identification number). Even if you think you will deal with a contractor only once, get that information up front in case you end up calling the contractor again during the year and ultimately pay more than \$600. Be aware that there is legislation pending that would repeal this reporting requirement (H.R. 705), but that legislation is tied to a repeal of some of the reporting requirements of the Affordable Care Act, so stay tuned.

Beware the lease-option: Recent legislation has put significant burdens on a landlord who desires to give a tenant the option to purchase the property. There have always been issues with the lease-option transaction that made prudent owners think twice about entering into one, but now, among other things, the landlord must give the prospective tenant-optionee the right to rescind the agreement within three business days after executing it and, more significantly, the landlord must sue the tenant in a proceeding similar to a foreclosure if the tenant does not buy the property and refuses to sign a document terminating the lease-option agreement. That proceeding would be in addition to the eviction proceeding the landlord may have to institute to simply get the tenant out of the residence. There are also special notice requirements regarding tenant default. Furthermore, and very importantly, a violation of the lease-option statute is considered an unfair and deceptive trade practice which may result in treble damages being assessed against the landlord.

Don't Go Away Scared, Just Prepared

Sure, being a landlord can sometimes be a headache. But if you are diligent and do your homework regarding residential rental laws in North Carolina and select good tenants to whom you provide fit and habitable premises, your experience as a landlord can indeed be a profitable one.

For further information regarding the issues described above, please contact Clifford P. Parson.

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