

**JOHN CUNNINGHAM'S LLC NEWSLETTER  
FOR TAX AND LEGAL PROFESSIONALS**

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**PROTECTING MULTI-OWNER REAL ESTATE RENTAL  
PROPERTY BY OFFLOADING PROPERTY MANAGEMENT  
SERVICES TO SEPARATE PROPERTY MANAGEMENT  
ENTITIES**

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EXECUTIVE SUMMARY. To avoid losing their properties in the event of a negligence suit, New Hampshire individuals and married couples who own multi-owner rental real property generally should not provide property management services relating to these properties except through a separate property management entity.

DISCUSSION

Thousands of New Hampshire husbands and wives own real estate rental property as joint tenants, and tens of thousands of New Hampshire individuals own real estate rental property through trusts, tenancies in common and multi-owner business organizations such as general and limited partnerships, multi-member LLCs and multi-shareholder corporations. For reasons of economy, many of these individuals and joint tenants also perform property management services with respect to their properties. These include repair and maintenance work, capital improvements, and tenant services such as admissions and evictions.

The rules governing real property ownership, including those governing real property negligence liability, vary greatly depending on the specific form of ownership in question. For example, there are vast differences in these rules as applicable to, on the one hand, joint tenancies and, on the other, multi-member LLCs.

However, under an ancient legal rule widely known even today by its Latin name as "respondeat superior" (which means, effectively, "the owner is liable"), if any of the above individuals or either member of any of the above couples are negligent in performing their property management services and the resulting negligence judgment exceeds their liability insurance, a court may impute this negligence to the joint tenants, trust or business entity owning the property and thus may require the sale of the property in satisfaction of the judgment.

Illustration. Individuals Jones and Smith own a 10-unit apartment building in Manchester as partners in a New Hampshire general partnership. The building is worth \$2 million, and it is covered by a \$3 million dollar liability insurance policy. To save costs, Jones, who is good with tools, does all the repair and maintenance work on the building. One day, while doing minor plumbing repairs, Jones forgets to fully close a valve, and the resulting leak triggers an electrical fire

in which two tenants die. The court imputes Jones's negligence to the Jones-Smith partnership; the deceased tenants' survivors win a \$5 million negligence judgment against the partnership; and the court orders the partnership to sell the building in satisfaction of the judgment and to transfer the sale proceeds to the survivors.

There is, however, a relatively simple and affordable means that, although not necessarily fool-proof, can go far to prevent the above result—namely, the use of a separate entity to perform the above property management services.

Illustration. Same facts as above. However, when the partnership owned by Jones and Smith buys the above apartment building, Jones forms a separate single-member LLC to provide repair and maintenance services, and the general partnership enters into a written contract with this LLC under which the LLC has exclusive responsibility for the building's safe maintenance and operation. When the above survivors bring their negligence suit, Jones's interest in the property and all of his other assets will be at risk, but Smith's will not.

In weighing the above factors bearing on whether to use separate property management entities to protect their interests in rental real estate, New Hampshire real estate owners should also consider the following additional factors:

- 1) Using LLCs as property management entities. For almost all New Hampshire businesses, the legal and tax rules governing LLCs are likely to be superior to those governing non-LLC entities. Thus, individuals and couples who decide to use separate legal entities to perform the above property management services should almost always form them as LLCs.
- 2) "Every case is different." As I've indicated above, New Hampshire rules determining liability for negligence in respect of real property vary greatly depending on, among other factors, the form of ownership of that property. Thus, real property owners shouldn't form separate property management entities until they've consulted with a lawyer about the specific facts and law relevant to their own situation.
- 3) Single-owner properties. Individuals who perform property management services in respect of rental real property of which they themselves are the sole owners generally cannot benefit from using separate entities to provide property management services with respect to their properties. This is because if they are negligent in servicing these properties, the victims of their negligence will very probably sue not only their property management entities but also these individuals themselves in their individual capacities. In these suits, both the interests of these individuals in their real property and also all of their other assets will be at risk.

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