



Lines of Defense

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Multifamily owners and managers have felt the pain of the last recession more deeply than in previous downturns. As a result, the property industry moved more aggressively than during previous downturns to focus on retention and to manage expenses that might previously have gone unnoticed. In addition, the industry became more attuned to the need of better protecting its bottom line against mounting bad debt, which is estimated at \$27 billion due to concessions, vacancies and unpaid rent industry-wide.

With financial risk management a key focus at both the corporate and property levels, solutions such as renters insurance, security deposits and alternatives to applicant screening and collections have become integral components of the effort to cut expenses and mitigate losses.

So what are the best practices for leveraging these financial risk-management tools? What should property companies look for when assembling a team of service providers and programs that can proactively help them improve their bad debt picture?

A resident who incurs bad debt can be a greater financial detriment than a vacant unit, a notion that has prompted the industry to embrace resident screening as a first line of defense in a financial risk-management program. All professionally managed apartments now employ a resident screening program, but not all screening programs are created equal. A resident screening program that features a sophisticated and consistent scoring model—such as those used for decades in the mortgage and credit card industries, for example—allows the property company to calibrate the

scoring threshold to meet its property's needs. By predicting the financial behavior of a prospect, the model then provides a score that estimates the credit risk of an applicant that may not fulfill his/her lease obligations.

A resident screening program can also better ensure compliance with corporate leasing policies and Fair Housing laws. A scoring model coupled with pre-determined, standard acceptance levels leads to a more consistent interpretation and execution of a resident acceptance policy. Uniform compliance with such policies also reduces the company's exposure to lawsuits.

Security deposit alternatives allow a property company to market vacant units more aggressively while better protecting it against financial losses than a traditional security deposit. Introduced a decade ago and now in place at more than 1.5 million units nationwide, security deposit alternatives, most often found in the form of a surety bond, allow a property company to reduce a prospect's move-in costs while protecting the community against financial losses due to excess damages or skipped rent. This level of protection is especially important in markets where low security deposit levels and move-in specials are the norm. Because the surety bond premiums that are paid by both performing and non-performing residents are pooled by the program provider for the property company's sole use, the property owner/manager typically has more money available to pay for the inevitable losses than he would with a single, lower traditional security deposit. In addition to the premiums, in the event of a claim by the property company, the amount that is received from the resident via collections exceeds the amount recovered from the resident alone to cover the claim with the use of a reduced security deposit.

Mandating renters insurance transfers the risk to the resident that caused the damages. By protecting a property's NOI from adverse or direct property loss, renters insurance can also potentially lower a property company's commercial insurance premiums. Look for a policy that requires minimal staff support, auto enrollment to residents approved to live in the community, online management reporting to track program participation and comprehensive coverage for high-value items.

A sustained and good track record means something in today's business environment. Providers come and go, but property managers need to look for one with staying power and one that has worked with property companies through a variety of economic cycles.

Local know-how can mean a world of difference. The rental housing industry is highly regulated, so property companies should look for a provider that knows the intricacies of the laws of each state in which they do business and where property companies have communities. Otherwise the latter may open themselves up to potential lawsuits for violating local statutes.

Choose the best of breed with which to work. Look for the ability to integrate among risk-management program providers rather than be forced to select from a provider's vast menu of services. Are they willing to turn on and off partners, or their own services, upon request? Flexible, open systems from a technological standpoint also mean smoother integration.

A comprehensive financial risk-management program is a business imperative for multifamily property owners and managers with an eye toward a healthier bottom line. But knowing what providers to pull into the mix and what to expect from them are critical to successfully managing your property's financial exposure while keeping expenses in line.

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