Solving the Risk

Apartment owners are relying on technology and experimenting with alternative forms of coverage to ensure they get the best protection—and profit—for their buck.

A recent study by one resident screening company found that more than 55,000 residents who initiated their leases over a six-year period moved out of their apartment communities owing money. Industry experts convened during the 2013 NAA Education Conference & Exposition in June to analyze this study of more than 750,000 U.S. residents of class A and B properties. Some of the results were surprising.

First, of those sampled, the majority of residents (56 percent) have credit scores below 700 (see chart on pg. 52). In part, the high percentage of lower scores is because Gen Y'ers (18- to 29-year-olds) comprised more than half of the applicants in the sample set. When reviewing the complete picture, this doesn't always demonstrate poor credit history, but could simply be attributed to a lack of time spent building a credit rating.

This is yet another reason to consider more than just a credit history for resident screening. Apartment managers should also check rental payment history to see if the prospective resident has ever been evicted, or has paid their rent on time at previous residences.

"Looking at just a credit score is like accepting a marriage proposal from someone you have only spent time with while at work," says David Haas, Managing Broker of Long Beach, Calif.-based Ernst & Haas Management. "You don't know all sides of who they really are. Similarly, credit scores don't tell the whole story."

Haas says his company follows a multi-step process that looks at various aspects of the person with whom they are about to enter a long-term relationship, including reviewing bank statements—"this tells us how they are managing their money, and if they're living beyond their means or paycheck-to-paycheck, which a credit report won't"—verifying income, cross-verifying all documents, requiring original documents and questioning previous owners.

"We'll call an owner at a previous residence, but in addition to asking the standard questions about payment history, we'll also

Management Maze

BY LAUREN BOSTON

ask them for the community zip code, the nearest cross streets and how long they've owned the property," Haas says. "All of this information is factual and can be easily verified, but when put on the spot, bogus landlords fold like cheap cameras."

Second, two skips means six times the risk. It may not be too surprising that a resident who has missed a past rental payment may miss one again in the future. However, such high-risk residents can be far more accurately predicted during the resident screening process based on specific red flags.

This study showed that while applicants with positive rental payment histories may have a nearly 6 percent default rate, renters with two or more prior debts run a rate nearly six times that (of 35 percent). Likewise, an applicant with two or fewer late or NSF payments on record showed nearly an 8 percent rate of default (see chart on pg. 53). Those applicants from the same sample who showed three or more late or NSF payments sky rocketed up to a nearly 17 percent default rate.

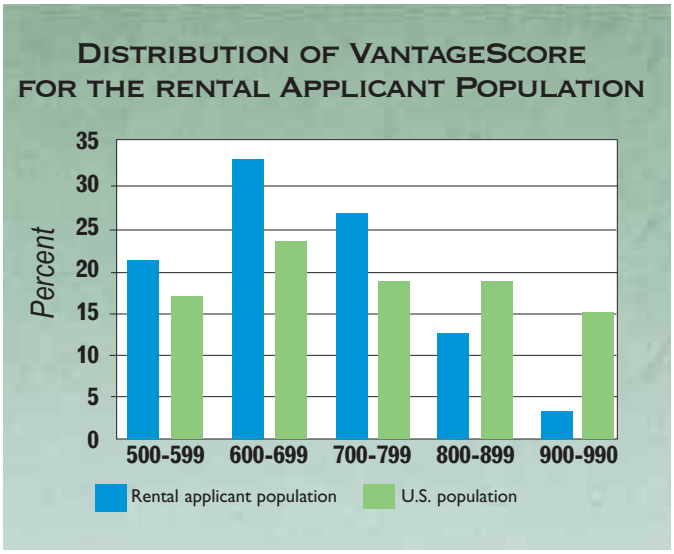
Data from this perspective indicates that while not everyone will have a pristine record, there is a defined line that applicants cross that brands them "high risk."

Although these procedures may not favor a prospective resident without the cleanest of backgrounds, by offering methods of building credit history—such as making payments on time—there becomes an added incentive that benefits both the resident and the owner.

Waiving Away Risk

A property damage loss waiver (PDLW) and a traditional renters' insurance (HO-4) policy are both widely used risk management tools employed in the apartment industry, but their differences are not always clearly understood.

A PDLW protects the insured—in this case, an owner or property manager—from up to $100,000 worth of damage caused by a resident as a result of fire, smoke, explosions, accidental water discharge or overflow and accidental sewer backup.



Source: U.S. population
http://www.experian.com/live-credit-smart/vantage-score.html.

The PDLW insurance premium—typically approximately $8 per month for a $250 deductible—is added to the resident's monthly rent. Therefore, the policy cannot be cancelled by the resident. The community receives continuous monitoring and tracking of the resident's required property damage liability protection ($100,000) through an automated reporting process.

Alternatively, an HO-4 covers residents for damage to (or loss of) personal property and assets. The personal liability piece of the coverage protects residents against liability lawsuits, medical bills or loss of income or guests injured in the apartment. It typically costs residents between $8 and $25 per month—paid directly to the insurance company—for a $250 to $500 deductible.

Jamie Allen, CAPS, Risk Management Coordinator for Indianapolis-based Buckingham Companies, says Buckingham employs both risk management tools by allowing its residents to choose a HO-4 policy on their own that provides a specific amount of asset coverage or to choose the PDLW coverage.

"The program we use through our insurance provider allows us to track both HO-4 policies and PDLW policies for coverage amounts, expiration dates and cancellations," Allen says. "This allows for a flexible approach to requiring liability insurance of our residents, while ensuring that our asset is protected."

Other management companies avoid risk by listing the owner as the "additional insured" on a resident's insurance policy. In doing so—and incorporating a few minor notification practices—owners can "force place" coverage on an apartment, should the underlying renters insurance plan lapse.

An "owner placed" liability plan—often described as an "owner's master policy program"—provides immediate coverage on an apartment, with the owner listed as the "named insured" and the resident named as "additional." These plans are typically cost effective, with average monthly premiums for $100,000 in "liability only" averaging $10 per month.

Some Choose In-House Insurance

Smaller, independent rental owners (IROs) are shifting the profit from the insurance company to themselves by obtaining a renters insurance service that includes revenue sharing on the front end, but also includes a "loss fund" on the back end that pays up to an additional 50 percent of the remaining premium after losses have been paid.

By doing so, IROs can retain 65 percent (or more) of the premium, while still maintaining proper coverage for their communities.

Alternatively, some larger apartment management companies are creating their own insurance programs by using a captive insurance company—established and customized to protect their specific business. A captive insurance company can retain up to 90 percent of all insurance premiums for residents' required liability insurance.

With a portfolio of 10,000 units, many owners could see annual profits upwards of $750,000. — *L.B.*

"Residents' payment history without question is the biggest predictor of how they are going to pay in the future."

—Carrie Polonsky
Director of Sales Performance
Advanced Management Company

More Data, More Dollars

Identifying the highest quality resident who pays rent on time every month is challenging, but failing to do so has significant financial repercussions and a direct negative impact on a community's NOI.

For Advanced Management Company (AMC), an Orange County, Calif.-based property management firm which owns or operates approximately 7,000 apartment homes, the need to rent to a higher-quality resident—one who is likely to pay rent on time each month and fulfill the terms of the lease as agreed—is critical.

To meet the need, AMC relies on its resident screening provider to access rental payment data, including information on more than 10 million residents nationwide, to determine an applicant's likelihood to pay rent in full and on time. The data provides AMC with a prospect's history of rental payments, previous and current lease start and end dates, as well as any bad debt balances or recent skips.

"[With our system] residents don't need to provide proof of coverage."

—Kelly Berchtold
Director of Ancillary Services
Alliance Residential Company

"Looking at just a credit score is like accepting a marriage proposal from someone you have only spent time with while at work."

—David Haas
Managing Broker
Ernst & Haas Management

"We believe residents' previous payment history is, without question, the biggest predictor of how they are going to pay in the future," says Carrie Polonsky, Director of Sales Performance for AMC. "Historically we would rely on manual verifications of a prospect's previous housing to gain insights into their payment habits. However, those methods often proved to be not only time consuming but not the most accurate, as some property managers weren't forthcoming or honest about a resident."

Rental payment data also helps property management companies better address the "gap" between when a resident is either evicted from a property or skips out on their rental agreement to when that outstanding debt information is reported on a credit report. Collection information can take upwards of 90 days before it's available on credit reports, but accessing rental payment history updated every 24 hours allows AMC to quickly and easily identify immediately reported data on prospects who have skipped from another community without fulfilling their lease obligations.

"Accessing the data during our screening process ensures we are not renting to any prospects owing money to any owner," Polonsky says. "If a prospect wants to live in our community, they must settle that debt first.

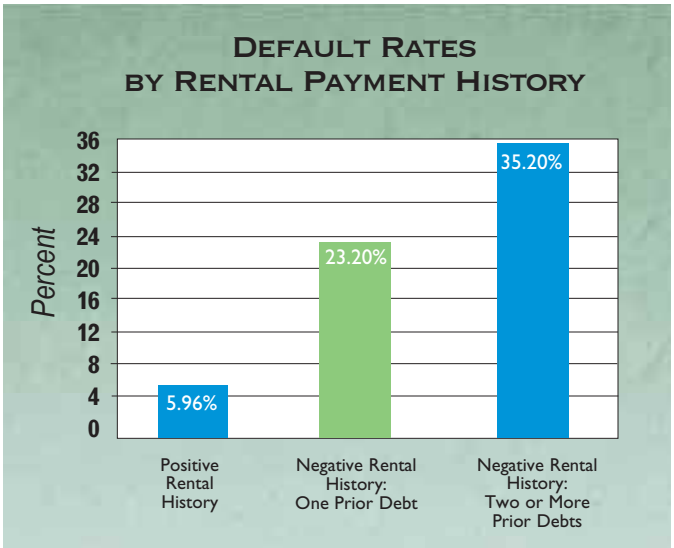
By sharing resident rental payment data, AMC is also helping other portfolios identify risky residents before they move in.

"Sharing of rental payment data is going to benefit all property management companies," Polonsky says. "And if we understand that, we participate more and we are better off as an industry. Participate immediately. Run, don't walk. Because the sooner you get this information, the better off you are going to be."

Due Diligence Goes Digital

In an ever-changing digital world, risk mitigation must also evolve. Increasingly, many owners and managers are utilizing digital strategies to generate and retain quality residents, generate efficiencies and reduce costs—and for good reason. One consumer research study of more than 4,000 apartment residents found that residents are looking for a mobile site where they can easily get a renters' insurance quote, select a plan and make a purchase on the spot in order to satisfy their community's renters' insurance requirements.

Thank you to Assurant Specialty Property, Renters Legal Liability®, Experian RentBureau, Yardi, CIC and Beecher Carlson for contributing to this article. For a full list of National Suppliers Council members who provide risk management services, see pg. 72.



Kelly Berchtold, Director of Ancillary Services for Alliance Residential Company, says residents do—and should—expect their renting experience to be effortless; obtaining renters' insurance is no exception.

"We added a link to our marketing material and select email notifications, and worked to integrate our service provider's system with our property management software," Berchtold says. "Resident policy information is automatically uploaded to our system, which means residents don't need to provide proof of coverage.

Upon purchase, an email confirmation is sent directly to the property management office, providing them with a convenient way to monitor coverage. Residents can also receive their policy documents via email.

"With this integration, our communities are able to manage coverage compliance quickly and efficiently, while simultaneously eliminating the potential for data entry errors and reducing administrative tasks—which ultimately translates to more time spent focusing on prospects and residents, and delivering the highest possible level of customer service," Berchtold says.

The consumer study also revealed that apartment residents want easy and quick online access to their claims information. Some sites now allow customers to complete the entire claims cycle online. They can file and track their claims, upload documents and photos, submit all required information electronically, receive automatic email notifications and view explanation of benefits upon completion of the claim.

"[We] track both HO-4 policies and PDLW policies for coverage amounts, expiration dates and cancellations. This allows for a flexible approach."

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