

Flexible Rentals

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Purpose: To educate National Apartment Association (NAA) members on the business model of flexible rentals, which may assist with occupancy goals and generating revenue, as well as to offer guidance on various providers in the marketplace, business implications and legal considerations should this option work for your apartment community or portfolio. The goal of this best practice document is to offer suggestions to aid in delivering an exceptional customer experience when implementing flexible rentals. Following is an exploration of a variety of different flexible rental strategies, including short-term rentals (STRs), renter-initiated shared stays, lease-up period lodging and master leasing, which create incremental income for renters and multifamily housing community developers and owners.

Applies to: Property managers, regional managers and all other NAA members who are involved in onsite operations overseeing flexible rentals.

Overview: Flexible rentals, also known as STRs, are defined as furnished apartments that are rented for short periods of time, usually by the month as opposed to annual rentals in the unfurnished apartment rental market. They are commonly viewed as an alternative to hotels, offering a chance for the resident to enjoy the lifestyle of a particular community by living life as a local resident for a shorter period of time. The concept of short-term rentals has evolved beyond the traditional model of allowing residents to host directly. Today, the market is fragmented, with multiple STR companies offering different business models to legitimize, streamline and control the entire hosting process. Many industry sources assert that consolidation in the crowded STR marketplace is inevitable.

According to AirDNA's August 2019 "Health of the U.S. Short-Term Rental Index," there are almost 2 million active flexible rentals listed across the U.S. Last year, revenue in the corporate-housing market—where apartments are typically leased for at least 30 days—rose 13 percent to \$3.62 billion, according to the Highland Group, a hotel consulting firm that studied the market for the Corporate Housing Providers Association. It was the fifth consecutive year of growth. The number of available apartments nationwide offered for long-term corporate rentals, typically in more expensive luxury buildings, rose 6.5 percent to 71,201 last year. The average daily rate was up 7.3 percent to \$161. "It is estimated that 65 percent of booked nights on Airbnb, for example, are in multifamily buildings," according to the 2017 NMHC article, "The Changing Face of the Short-Term Rental Business."

Flexible leasing arrangements enable operators to maintain occupancy and increase revenue. Using a comprehensive data set on Airbnb listings from the United States, there is a 10 percent increase in Airbnb listings that led to a 0.39 percent increase in rents. Some apartment owners are seeing the flexible rental space as an opportunity to monetize their vacant units. And, with the way the short-term market has evolved during the past few years, there now exist friendlier business models for apartment owners. For example, it's now possible for an owner to lease a block of apartments in bulk on a long-term basis to one of the growing number of companies.

Incorporating short-term rentals into your multifamily housing community can have the potential for top benefits, such as reducing vacancy by diversifying customer base to fill empty units, boosting net operating income (NOI) through multi-year leases with guaranteed market rents and providing additional amenities to full-time residents including discounts and event planning. In this best practice document, we will explore areas of opportunity and potential challenges to consider when discussing possible business models for entering the flexible rental space.

Guidance:

1. **Turnkey Providers** — Management companies' partner with an end-to-end STR provider like Lyric, Sonder, Stay Alfred, Vector Travel and others that manage the entire guest hosting workflow. The STR provider is responsible for security and guest information, noise monitoring, staffing, regulatory compliance, housekeeping and managing the logistics from check-in to check-out, baggage storage and waiting areas. Advocates of this model argue that turnkey partnerships enable a guaranteed lease payment for a defined number of apartment homes, at market rent, for a predetermined number of years. The community can lease-up faster and benefit from a built-in rent increase each year. Additionally, the community can use an available STR unit as an amenity for residents and a leasing tool for prospective residents.

For turnkey partnerships to be successful, it is critical to align with an appropriate STR partner that shares similar views on customer experience, service and product quality. AvalonBay Communities recommends choosing a provider with significant capital and/or require a significant deposit or letter of credit. Like insurance, banks issue this as proof of future payment in the event of nonpayment. Operationally, it is important to remember that most buildings are not designed with the STR model in mind. The client and the STR provider must work in tandem to define the entire workflow, preparing for every step of the guest experience. This individualized process differs from building to building. Relevant checks and balances, including price, can ensure the management company avoids attracting unfavorable guests. Additionally, it is important to have open communication with residents to secure their buy-in.

2. **Resident Subleasing**

This model is synonymous with Airbnb. Some sources believe that roughly 5 percent of all apartment homes are “unofficially” on Airbnb for those communities that do not legally allow it. Many management companies are working to legitimize this and gain more control of the listings by working with platforms such as Pillow or through the Airbnb Friendly Buildings Program. Preventing residents from subleasing/hosting guests themselves allows the owner/manager to retain overall control of the apartment community.

Specifically, this model presents the overall community with significant challenges, including:

- *Resident Security* — A lack of comprehensive background checks and low control over the entry of guests leads to reputation-management concerns.
- *Overall Sense of Community* — Takes away the feeling of community, as there is a constant flow of guests.
- *Location* — Not all communities are attractive; direct subleasing is suitable mostly for those in high-entertainment or core business areas.
- *Regulatory Considerations* — Local regulations, the homeowner's association and/or investor limitations may restrict a community from engaging in STR, placing the apartment owners at increased risk (i.e., fire code approval – an NAA member company experienced multiple physical changes required by the fire marshal).

- *Minimal Return on Investment* — Companies report that even while working with STR platforms that enable residents to directly sublease their apartment homes, there are a variety of logistical challenges and the return on investment is low.

3. **Platforms** — Management companies' partner with an end-to-end STR platform such as ApartmentJet (now part of Expedia Group Multifamily) or Kigo, which manage the guest-hosting workflow. The STR platform is responsible for security and guest background checks, access control, regulatory compliance, contacting housekeeping and managing the logistics from check-in to check-out. The platforms do not manage baggage storage, physical check-in/check-out or waiting areas. Advocates of this model argue that managed guest suite/platform partnerships place more of the revenue opportunity into the hands of owners and operators versus third parties. Additionally, the community can use an available STR unit as an amenity for residents and a leasing tool for prospective residents.

For a managed guest suite partnership to be successful, it is critical to align with an appropriate partner that shares similar views on customer experience, service and product quality. Operationally, it is important to manage expenses such as furniture, utilities, cable and Wi-Fi because this expense falls on the community versus the third-party provider.

4. **Lease-Up** — During lease-up, short-term providers can bring apartment communities a substantial occupancy boost. The advantages of leasing apartments to a short-term provider during lease-up injects immediate occupancy and revenue that otherwise might take between 18 and 24 months. Apartment owners and developers want flexibility in leasing arrangements to ensure that controlled inventory is not hitting the market all at once.

Some short-term rental operators straddle the line of long-term residents and Airbnb by working with real estate developers to turn floors of unleased apartments into furnished hotel units. This practice has become particularly popular in partnering with buildings under lease-up to assist owners with revenue while marketing to long-term residents. There are several professional short-term providers to choose from including, Domio, Lyric, Sonder, and WhyHotel.

In this business model, the operator will assume management of the empty apartments in a lease-up and then rent them on hotel and short-term stay distribution platforms like kayak or booking.com and maintains all servicing and responsibility for reservations and the guest and provide their own concierge and staff. The agreement is either a hotel-like management agreement or retail-like lease which, provided the correct regulatory approval and compliance with building life-safety requirements, allows for the operation of a serviced long-stay hotel out of the vacant new construction apartments.

It is important to note that there may be financing requirements limiting the number of flexible rentals at communities under lease-up as well as requirements for compliance with regulations, permits, commercial certificates of occupancy resulting in changes to the millage rate and ADA standards. Owners/developers should communicate and work with the short-term provider as well as with their legal counsel and financial institutions to ensure the number of short-term leases offered does not surpass the allowable amount to obtain permanent financing for the community and all regulations are properly met.

5. **Operational Considerations** — Operational issues to take into consideration when planning to offer flexible rentals include:

- *Location of the Apartment(s) Within the Community* — Whenever possible, isolate the STR units in a community to avoid disturbing long-term residents with guest activity.

- *Establish an Operational Workflow* — The STR provider and the management company should define the entire workflow from building, floor and apartment access to check-in, check-out, baggage storage and waiting area. It's an individualized process that demands time to define and must be done in accordance with the building's purpose and design. The resident experience should be kept in mind when planning this process.
- *Resources for Guests* — A 24-hour helpline for STR guests should be available.
- *Internal Communication* — If a company has a 24-hour contact center for residents, it should be informed of the availability of STR apartment homes, as they may receive a call from a guest and should be able to appropriately handle it.

Aside from concerns from apartment executives wondering whether operators can harm their brands and their residents' quality of life, there are other potential operational challenges to consider before proceeding:

- *Access Control* — Lack of 21st century access controls are a challenge because ease of access is imperative to guest satisfaction. Expedia Group recommends a smart lock solution for all access including community access like garages, gates and the like. These locks can be programmed for an exact check-in and check-out time from a remote location.
- *Technology* — Research reveals that the majority of guests do not want to interact with staff. It is important to plan out all communication avenues from check-in to check-out that ensure a seamless experience for renters without ever stepping foot in an office or meeting with a staff member. Most STR companies utilize their website or a phone application for all communication.
- *Apartment Class* — According to Lyric, in general, class B suburban communities are challenging to operate in as the demand for short-term rentals is low in these communities and areas. Further, apartments that have an inexpensive ADR (average nightly rate) and are larger (by bedroom count) tend to attract an unfavorable guest or larger groups, respectively, which often detracts from a quality resident community.
- *ADA Compliance* — The need for ADA compliance is becoming more prevalent in cities that can require visual and audible indicators, surface retrofits, grab bar installation, kitchen and bath countertop modification and community retrofits.
- *Asset Valuation* — How an asset is valued externally could be affected. While more revenue should increase the valuation, conservative pension fund managers may view the fluctuation in NOI as a risk of physical asset damage to reduce valuation.

6. **Legal Considerations** — Short-term rental providers are contractually obligated to know and follow local rules and regulations. They are required to secure the regulatory approvals necessary for that area. Between the changing local laws, tax laws, business licenses and fire-code regulations, most apartment community owners may struggle to keep pace with the rapidly changing short-term rental regulations. Areas of flexible rentals to consult legal counsel about may include but are not limited to:

- Municipality restrictions
- Licenses and permits
- Insurance
- Screening procedures
- Taxes

When apartment community owners or managers determine that entering the flexible rental marketplace is not for them — or is prohibited in their jurisdiction — there are ways they can protect themselves from unlawful short-term rentals. Owners and managers should ensure all lease agreements with residents specifically indicate that flexible rentals are prohibited. They can also

make the breach of that covenant a material breach of the lease agreement and cause for eviction (owners and managers should consult local counsel to discuss eviction laws in your locality, including any just-cause eviction statutes). Additionally, owners and managers can add a clause to the lease agreements that hold the resident responsible for any damages, losses or fines incurred as a result of a lease violation.

7. **Guest-Screening Liability** — It is important to decide how guests of flexible rentals will be screened, and whether the management company/owner or STR company should oversee this process and complete necessary administrative tasks, such as paperwork, associated with the rental. Consider who will be responsible for screening participating guests and whether it's possible to outsource guest screening. If an apartment community owner is reserving apartments for renters, the responsibility for screening lies with the owner. But if an owner is allowing a resident to rent out their apartment, who is responsible for screening participating guests? Create a checklist of ideal guest criteria and qualifications that all residents must observe when selecting short-term guests. The guidelines for screening should meet the current community standard for long-term residents.
8. **Amenity Opportunity** — The younger generations of our customer base have acknowledged their willingness to participate in the sharing economy of flexible rentals, but they also see it as an amenity often sought in apartment rental housing. In 2019, J. Turner Research polled more than 12,000 residents regarding their willingness to live in a community that allowed short-term rentals for a day or week, and only 19 percent of respondents indicated “definitely not.” This reinforces the opportunity for apartment communities to explore this revenue option without sacrificing resident satisfaction.

Long-term residents have an opportunity to rent STR units at a discounted rate. This allows residents in smaller apartments to have guests within the community without compromising their own space or privacy. In addition, STR units may be available at a comparative hotel rate. For prospective residents, there is an opportunity to allow a complimentary one-night stay for them to experience the community without commitment prior to reserving their new home. Think of this as a “try it before you buy it” scenario that can assist in the lease closing process.

9. **Business Benefits** — You are in the business of leasing apartments, so why would you enter the world of flexible rentals, which could distract you from your main priorities? The most frequent argument in favor of STR providers is the guaranteed lease payment at market rent, with built-in rent increases each year. This helps a community lease-up faster and offset operational deficiencies. Other key business benefits may include guaranteed leases for an extended period, an annual rent increase of 2 to 3 percent built into the contract and increased resident satisfaction from resident amenities and discounts. Vector Travel estimates that short-term rentals can produce up to three times the revenue of long-term rents, making them desirable to nearly every multifamily housing company.

Related Links and Forms

[Short-Term Rentals – Deal or No Deal](#)

[Straight Talk on Short-Term Rentals](#)

[Allowing Short-Term Rentals in Multifamily Buildings](#)

[ApartmentJet Case Studies](#)

[The Pros & Cons of the Top Five Multifamily Short-term Rental Models](#)

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About NAA

The National Apartment Association (NAA) serves as the leading voice and preeminent resource through advocacy, education and collaboration on behalf of the rental housing industry. As a federation of more than 150 state and local affiliates, NAA encompasses over 82,000 members representing more than 10 million apartment homes globally. NAA believes that rental housing is a valuable partner in every community that emphasizes integrity, accountability, collaboration, community responsibility, inclusivity and innovation. NAA thanks its strategic partners Maintenance Supply Headquarters and Yardi. To learn more, visit www.naahq.org.