

Rent From Payroll: The Ultimate Value Booster

Offering apartment residents a lower cost option for moving in—**while practically guaranteeing on-time rent delivery**—has adopters of rent from payroll boosting cash flow and net operating income for enhanced property values.

It's simple economics. When rents go up, it becomes harder for people to afford leasing an apartment.

Since the end of the recent recession, apartment owners have been gaining back some of the deep discounts they made to keep properties full. According to data collected by the Washington, D.C.-based National Multi Housing Council, average rents between 2009 and 2013 increased from \$1.10 to \$1.26 per square foot—a 14.5 percent recoup for the average property portfolio.

Prices, Rents, and Capitalization Rates for Apartment Properties			
Year	Price (\$ per square foot)	Annual Rent (\$ per square foot)	Cap Rate (%)
2008	\$138	\$1.15	6.4%
2009	\$120	\$1.10	6.8%
2010	\$149	\$1.13	6.6%
2011	\$153	\$1.18	6.4%
2012	\$154	\$1.22	6.1%
2013	\$150	\$1.26	6.2%

Source: NMHC interpretation of U.S. Census data

But for most typical renters—working class families, recent college graduates, and young professionals climbing the career ladder—qualifying for a new apartment lease just gets tougher as monthly rents increase.

With rents growing as wages remain flat and average renter credit scores still reflecting the tough economics of the recession (see “**What's the Score?**,” page 2), larger numbers of renters are being labeled “Conditional Approvals,” where leases are offered based on additional contingencies. These contingencies—additional security deposits of up to two months’ rent and/or a guarantor/co-signer—make it difficult for property owners and managers to close the deal with a conditionally approved renter.

Times aren't just tough on renters. Apartment community owners and managers are also pressured as it becomes more difficult to qualify and move-in residents who can pay rent in-full and on-time every month. The result can often mean lower physical occupancy (less residents moving in) and less “economic” occupancy (fewer residents able to pay rent on-time, or pay rent at all).

“There are always one or two of those leases where your entry points are just a little high for some

individuals,” explains Alfredo Lopez, director of auxiliary services for The Lynd Company based out of San Antonio, Texas, which manages 30,000 apartment units across the Southeast United States where the number of conditional approvals is on the increase—as high as 65 to 75 percent of all applicants at some of the company’s 130-plus communities.

However, big cash contingencies are being recognized as a less effective and potentially unfair way to get more of those conditionally approved residents moved-in to an apartment. “Sometimes our industry thinks ‘if someone can come up with a good chunk of money, they’re worth the risk,’” says Lopez.

The problem, according to Lopez, is that inflated security deposits don’t insure payment performance from residents and might be spreading thin finances even thinner, setting residents up to fail. “Asking someone to come up with a whole bunch of money is only proving that they can come up with a whole bunch of money in a short period of time. Sometimes that quickly leads to other challenges.”

That’s where rent from payroll comes in. The Lynd Co. adopted the solution this year, joining the ranks of other professional apartment owners and managers like Houston-based Camden Property Trust, Indianapolis-based Gene B. Glick Co., and Newton, Mass.-based Northland Investment Corp. These firms have turned to a rent from payroll solution as a way to offer conditional approvals a lower cost option to move in, while at the same time providing greater certainty to rental communities that rent will be delivered in-full and on-time every month.

In fact, as more apartment owners begin including rent from payroll lease options, they’re finding across-the-board increases in the number of people who can say yes to a lease offer as well as an incredible track record of

What’s the Score?

While average U.S. consumer credit scores are slowly inching their way upward from the economic fallout of the recent recession, credit thresholds remain a critical issue for American renters, who typically exhibit scores lower than the national average.

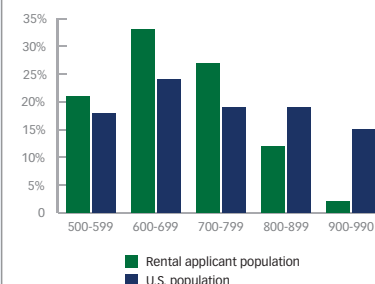
According to a study of 755,000 leases conducted by Costa Mesa, Calif.-based Experian® RentBureau®, 85 percent of renters are in one of the three lowest credit ranges (Vantage Score 501 to 799), compared to a national average of only 64 percent.

Property managers typically use a combination of rent-to-income ratios, criminal background checks, and credit scores to qualify and approve renters for an apartment. As rents escalate, the lower average credit score of apartment residents in tandem with tougher rent-to-income ratios results in more applicants being approved “with conditions.” Historically, those conditions meant significantly higher security deposits or additional months of rent upfront.

Rent from payroll is one way property managers are alleviating lease applicants of that burden. By opting

to have their employer direct deposit funds into a rent from payroll account, conditionally approved renters with lower credit scores can qualify for an apartment without having to come up with extra security deposits. On-time rent payments made via employer direct deposit are reported back to a major credit reporting agency, thereby helping residents who are taking steps to rebuild credit.

Distribution of Vantage Score for the Rental Applicant Population



Source: Experian®

on-time rent delivery, all contributing to increases in overall financial health and value of their real estate.

More Move-Ins, Less Flame-Outs

That’s because rent from payroll dispenses with the outdated “all-in” mentality of requiring huge move-in deposits from conditionally approved lease applicants.

Instead, renters agree to have their employer deposit funds into a FDIC-secured, third-party managed rent account every pay period. When monthly rent is due, the property receives an automatic electronic disbursement to satisfy rent for every resident enrolled in the program, and residents get their timely rent delivery reported to a major credit bureau.

“When your only option is to ask conditionally approved applicants to amass larger security deposits at move in, you eliminate their ability to fall back on those funds. You almost force them to flame out,” says Heschel Asset

Management principal Dave Sherbal, an apartment industry veteran who has directed asset management for the Fifteen Group and JPI Companies.

“If we can get our standard security deposit without having to clean out their bank account, and we’re several weeks ahead of them on rent deposits, we know we’re building great economic occupancy at our communities,” Sherbal says. “Even when residents face job loss, we often have two weeks or more of rent deposits in-hand already from the resident’s employer to work things out. As far as I’ve seen, the fail rate percentage on rent from payroll is zero.”

At face value, the majority of conditionally approved residents aren’t deadbeat renters—they’re just normal people with decent jobs who experienced a credit ding or financial mishap or two and may not be great at managing their money or budgeting.

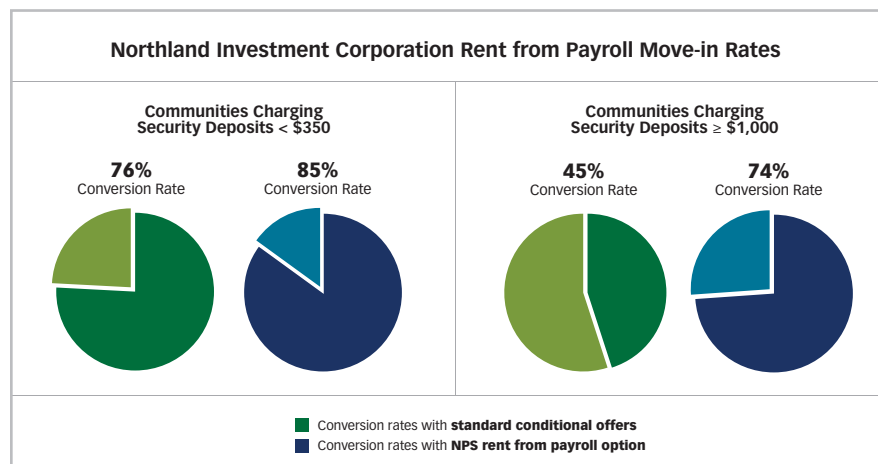
Northland Investment Corporation director Kate Moriarty oversees leasing policies at her company’s 22,000 apartment units in Texas, Florida and New

England. She says the sheer number of these overlooked renters continues to rise, and they're particularly attracted to programs that help manage and build or rebuild financial independence.

"The reason rent from payroll is so great at conversions is because we're talking about a sizeable demographic of people with minor financial mistakes who still need a place to live and really want to rebuild their credit and improve their financial management," Moriarty says.

After implementing rent from payroll at selected communities across the Northland portfolio, conversion of conditionally approved residents jumped from 68 percent to 82 percent, improving move-in volume by 21 percent among the conditionally approved. At Northland communities where conditional deposits were greater than \$1,000, the rent from payroll effect was even more profound, propelling a weak 45 percent conversion rate to 74 percent when conditionally approved lease applicants were offered the rent from payroll option.

These types of conversion improvements are near universal for companies



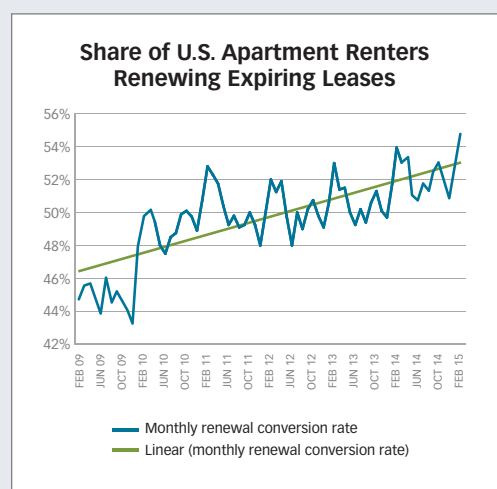
adopting rent from payroll. And although rent from payroll can help lower costs and fees for renters at luxury communities (see "**Stuck on You**," below), the solution works particularly well at "B" and "C" class communities, where 20 to 40 percent of the applicant pool are approved with conditions.

"Across our properties, as rents rise, we tend to also see a rise in conditionally approved applicants," says Jason Whittington, vice president of business solutions at Gene B. Glick Company,

which owns and manages 21,000 apartments units across the Midwest.

At Glick properties where rent from payroll has been offered to conditional approvals, move-ins have increased from a conversion rate of 52 percent to a 77 percent conversion rate on rent from payroll offers—overall a 48 percent improvement. "As a result, anywhere there is a larger number of conditionally approved applicants, we're clearly going to apply the rent from payroll solution," Whittington says.

Stuck on You



Source: MPF Research

With rents on the increase and wages flat, more apartment residents than ever are trying to stay put in their current digs. As a result, renewal rates have been climbing since the economic recovery started. Year-over-year, renewal conversions jumped to 57.5 percent in February 2015, according to New Carrollton, Tex.-based MPF Research, extending a stretch of 22 months without negative year-over-year change.

That said, more than four out of 10 renters are still electing to pull up stakes and find a new apartment when lease renewal rolls around. Rent from payroll, increasingly used to help renters with less than perfect credit qualify for a new apartment, is providing an "anchoring effect" and keeping residents in place longer—66 percent longer than those renters who opt instead for increased security deposits.

Progressive apartment owners and managers say the longer length of stay is almost always financially preferable to letting a resident go and trying to raise rents and attract a new renter. "We actually see better income growth over time in same store, same resident versus same store, new resident, even though our renewal increases are at a lower rate than our new lease rates," says Gene B. Glick Company vice president of business services Jason Whittington.

Rent from payroll could also start seeing broader use among renters at luxury properties, too. "We do receive some calls from A-class assets where rent from payroll might provide a conversion solution," says Northland Investment Corp. director Kate Moriarty. "If there is a credit qualification at a high-end property that necessitates one month of extra rent which is already quite high, rent from payroll often becomes very attractive as an alternative to close a lease that might otherwise be lost due to higher move-in costs."

Eliminating Payment Friction, Enhancing Property Value

Part of the broad appeal of rent from payroll for property managers and renters alike is the elimination of friction over monthly rent payments. Since funds for rent are automatically set aside from employers via direct deposit to the rent from payroll account managed by a third-party, renters never have to bother with the monthly exercise of scraping together rent. Likewise, property managers are alleviated from having to chase down and harass late payers in order to maintain consistent cash flow.

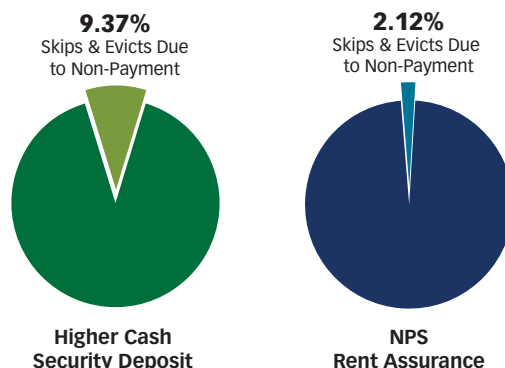
Moriarty even goes so far as to say rent from payroll—while converting much larger numbers of conditional approvals—tends to chase away bad-character renters. “The worst of the chronic late-payers and lease skippers will avoid rent from payroll because it designates the money they’d rather spend elsewhere as rent before the funds ever become discretionary,” she says.

Moreover, rent from payroll adopters report significant decreases in “bad debt” such as chronically late/missing rent payments and residents who simply skip out on their lease or are forced into eviction due to non-payment.

According to an analysis of 6,597 conditionally approved applicants conducted by Boston-based rent from payroll provider Neighborhood Pay Services (NPS), skip and eviction rates drop from 9.37 percent to a mere 2.12 percent when rent from payroll is applied—a 77 percent decrease. Given an industry average of \$2,000 to \$4,000 in vacancy loss and to repair, repaint and “make-ready” a vacant unit for new occupancy, the cost of unexpected move-outs drops by as much as \$250,000 for every 1,000 conditionally approved move-ins on a rent from payroll program.

Presenting an offer that conditionally approved residents can accept right away rather than requiring them to secure additional move-in deposits and/or a guarantor/co-signer also increases leasing velocity and turn times.

NPS Impact on Reducing Skips and Evictions



77% Decrease in Evictions/Skips and Bad Debt at Move-out

- Skip/eviction rates and corresponding bad debt decrease by 77% for residents on a rent from payroll program.
- On 1,000 conditionally approved move-ins, the cost of unexpected move-outs drops by more than \$250,000 using an industry average of \$4,000 per turn.

Recent integration of rent from payroll into leading resident screening solutions has accelerated offer delivery even further, generating a rent from payroll-based approval alongside typical approved, approved with conditions, and denied results. With more conditionally approved residents converting faster, apartment owners and managers can reduce the time it takes to fill made-ready vacancies and subsequently see reduced “days on market” and the associated marketing dollars spent to lease the unit over time.

According to the National Apartment Association 2014 Survey of Operating Income and Expenses, associated marketing spend was another \$169 per unit on top of make-ready costs. Owners are therefore looking for opportunities to renew residents and keep them at their properties longer. Even with the opportunity to raise rents on a vacant unit, “once you factor in turning and remarketing the unit, it’s much more financially beneficial to keep residents in place,” says Whittington.

For Whittington and other rent from payroll adopters, renewal rates are bolstered by the fact that renters on the program tend to stay in their units 66 percent longer than conditionally

approved residents who moved in with extra deposits.

Significantly better payment performance, longer lengths of stay, decreased bad turns, and increased conversions and occupancy all improve the net operating income—and therefore the underlying value—of apartment properties using rent from payroll solutions (see “On the Block,” page 5). What’s more, rent from payroll’s high efficacy rate at “B” and “C” properties further positions owners of those properties for higher rates of return as investment dollars head to that sector.

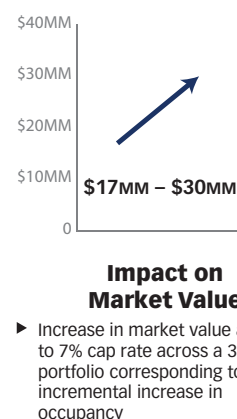
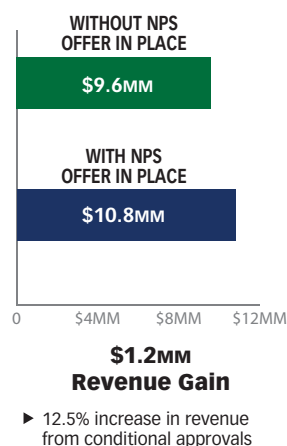
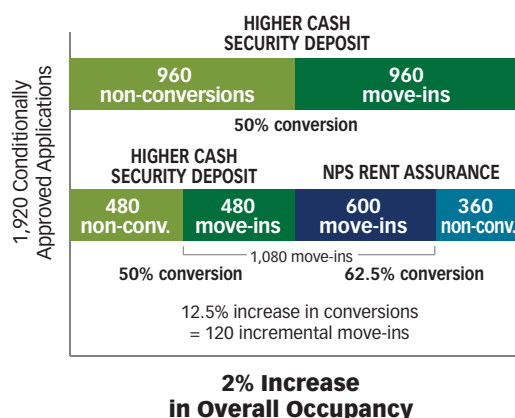
“Some of our growth has been in luxury communities, but the majority of the growth we’re expecting in the second half of 2015 is solid ‘B’ and ‘C’ class investments,” says Lopez, who will look to improve values by extending use of rent from payroll at new properties with high rates of conditional approvals. “In addition to the increased occupancy and length of stay, I think you are improving the overall resident demographic of your property, and that’s what I’m really looking forward to.”

By lowering the cost for renters to move-in and improving their performance as well as the long-term value of

On the Block

Annual Incremental Revenue Gain Using Rent from Payroll

6,000 Unit Portfolio



The apartment industry has historically enjoyed a vibrant real estate resell market. After development, a community can change hands several times as successive investors add and subtract assets to their property portfolios. As communities age, additional waves of “value-add” investors become interested buyers as they look for opportunities to remodel and revamp properties to resell at a profit.

Used universally to determine the rate of return for apartment property investments, the capitalization rate—or cap-rate—is the primary measurement of apartment

asset valuation. It is determined as the annual income generated by a property divided by the property's total value or price. Thus, the more income a property can generate relative to its price, the more attractive rate of return it has for investors.

While property values are market dependent, community operators can improve income by increasing revenue or decreasing expenses and thereby achieve a more attractive cap rate. Rent from payroll does both. On the back-end, rent from payroll results in a 77 percent decrease in costs associated with skips and evictions from non-payment of rent.

By improving conversion rates of conditionally approved lease applicants, apartment owners can turn vacant units faster, avoiding the operating and advertising costs associated with extended “days on market.” Most importantly, the average two percent in incremental occupancy gained from rent to payroll (given a base \$800 rent) can increase revenue on a 6,000-unit portfolio by \$1.2 million.

The resulting improvement to market value for an average 30-property portfolio at a 4 percent to 7 percent cap rate is \$17 million to \$30 million, respectively.

apartment real estate, rent from payroll is simple economics for apartment owners, property managers, and renters alike. Regardless of increasing or decreasing rents, the rent from payroll solution offers a win-win option for conditionally approved lease applicants to move into a rental home at costs that won't set them up to fail, while dramatically improving income and revenue and decreasing costs for community operators.

“We're selective and conscious of only

adopting high-value solutions that are easy to implement,” says Whittington.

“To me, rent from payroll is one of the few things you can do that fulfills a mission purpose and a profitability purpose—we're really providing a great tool to our residents to help them manage their finances and improve their credit, and we're also improving our ultimate bottom line.”

This is the first in a series of articles exploring customer-centric solutions for improving operational performance and increasing property values at multifamily apartment communities. The next article in the series (Fall 2015) will focus on technology integrations helping to redefine the screening and prospect approval process to identify and convert renters with highest lifetime value to property managers and investors.