Executive Summary

For many hard working American families, rent is often their biggest monthly expenditure.

Despite broad economic recovery from the recession, wages have failed to keep pace with rent increases driven by market demand and the inaccessibility of the for-sale housing market to the average consumer. As a result, millions of renters are finding it harder to qualify outright for moderately priced market rate rental apartments.

In an effort to move in this dramatically increasing population of renters, responsible apartment owners and managers have often relied on the application of increased security deposits in attempting to offset the risk of late or missing monthly rent payments. But the role of security deposits has evolved over the past 20 years from that of a protection against unit damage when a resident moves out to a de facto added layer of lease requirements intended to protect against payment risk in the event a resident is unable to deliver rent in-full and on time.

NPS RENT ASSURANCE
RENT FROM PAYROLL

Paradoxically, the request for additional money up-front encourages rental applicants to look elsewhere for housing in many cases. For renters who do move in, extra security deposits neither guarantee future rent payments nor provide any financial discipline to empower residents to deliver rent on time—and likely set renters up for failure by depleting finances with the very act of signing a lease.

Across the country, as it becomes more cost-prohibitive for average Americans to afford rental apartments, innovations have emerged to lower the cost of move-in for conditionally approved residents while significantly enhancing their payment performance. The combination of rent from payroll with resident screening solutions is providing apartment communities with a dependable tool for moving in greater numbers of conditionally approved renters who stay longer and pay rent reliably, all without the use of increased security deposits.

This report will show how implementing a rent from payroll option:

The result is more financially stable renters, greater income flow to apartment communities, improved value of underlying real estate assets, and greater operational efficiencies for rental properties no longer burdened with having to chase down renters for monthly payments or evict residents who have been unable to meet their rental obligations.

Affordability of Apartment Rentals Becoming a National Issue as Rents Increase

In the first half of 2015, average apartment rents in the United States increased 5 percent, continuing a multi-year trend of rent increases in most major metros across the country. While unemployment dipped down to 5.1 percent by the mid-year mark, wages have remained relatively flat. As a result, housing affordability for the 65 million Americans that seek rental options has become a greater financial burden, particularly for the large numbers of individuals and families for whom rental screening results in requests for increased security deposits as a supposed means to offset future payment risk associated with lower credit scores.

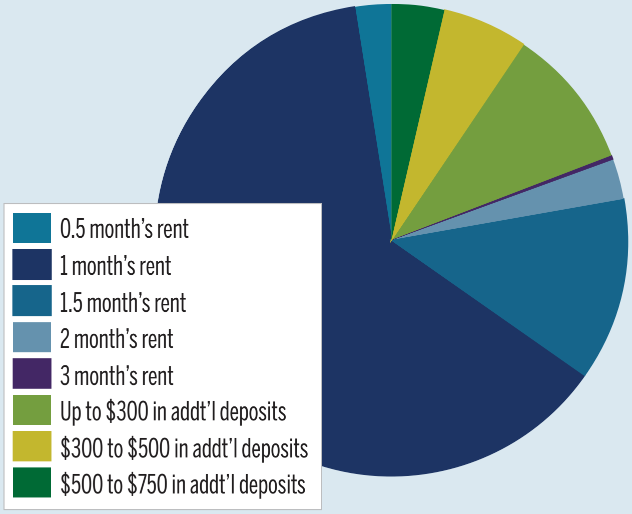
Rent increases naturally follow from broader market demand for apartments and apartment investors have continued to benefit from depressed home sales resulting from the recent recession. But when rent growth widely outpaces wage growth, greater numbers of would-be renters find it more difficult to qualify for an apartment lease that is—in essence—an annual financial obligation representing thousands or tens of thousands of dollars. In fact, rent often represents the largest and most significant monthly bill payment that working Americans strive to make.

While policies vary from community to community, apartment managers will typically qualify renters with screening software that analyzes credit score and rental history, assesses a criminal background check, and assists in calculating a rent-to-income ratio. Rooted in the Brook Amendment passed in 1969 to cap rent for public housing at a percentage of resident income, the rent-to-income ratio is a general recommendation by the U.S. Department of Housing and Urban Development to allocate no more than 30 percent of monthly income to housing.

As more and more renters struggle to find rent-to-income affordability that can qualify them outright for apartment leases, the numbers of “conditionally approved” lease applicants is increasing dramatically, and can represent 20 to 40 percent of all community lease applicants. With credit or income issues often placing them just outside of community qualification thresholds, conditionally approved residents traditionally are accepted as renters only after meeting additional contingencies.

Nationally, those contingencies more often than not require already financially stretched renters to provide additional money up front in order to move in. Though intended to mitigate risk, additional security deposits ironically can deplete the financial resources of conditionally approved residents, increasing the likelihood of late and missed rent payments after move-in.

Initial Conditional Deposit Costs



According to a Neighborhood Pay Services analysis of 247,305 conditionally approved leases initiated between August 2014 and August 2015, as identified by screening service provider First Advantage, nearly two-thirds of conditionally approved residents are required to provide an additional one month of rent upfront in order to qualify for their apartment lease, and another 12.5 percent of renters have to provide one-and-one-half months rent upfront. An additional 2.8 percent of conditionally approved residents are required to pay an additional two months of rent, and some are even required to provide three months rent to qualify for their lease.

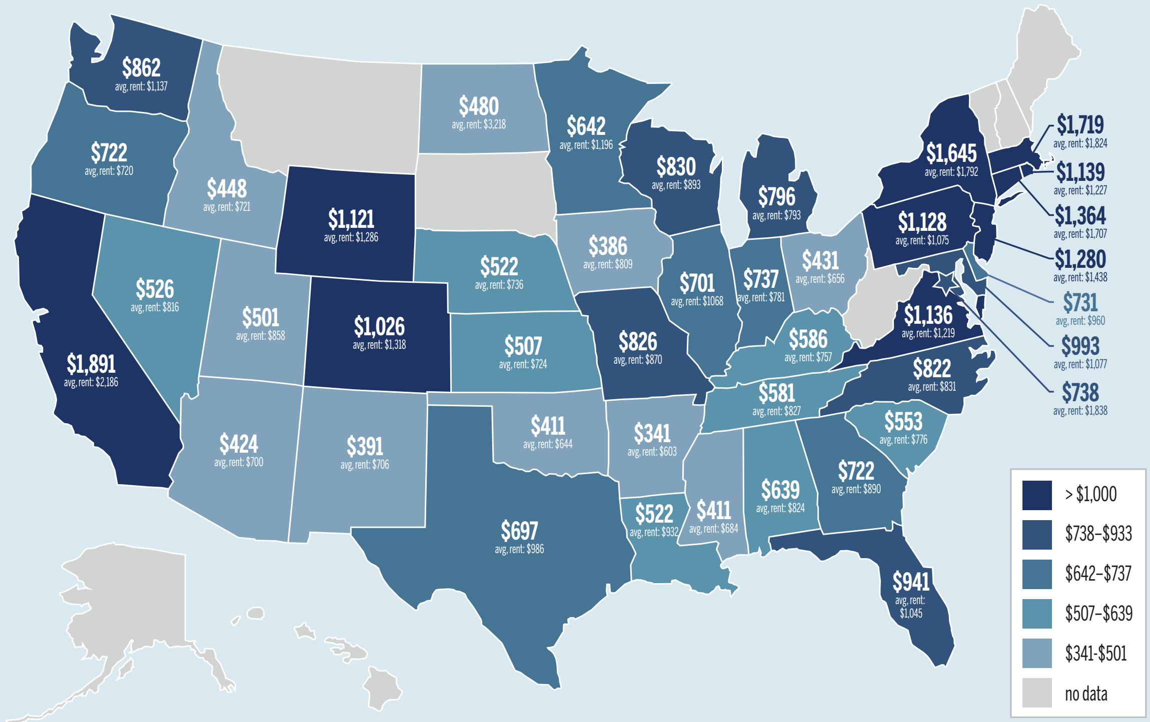
While increased security deposits based on rent are the most common lease add-ons for conditionally approved applicants, some apartment communities opt for flat fee deposits ranging from $100 to $700, according to the Neighborhood Pay Services analysis of First Advantage data. The result is typically the same: faced with higher move-in costs, lease applicants either opt to rent elsewhere, or move in under a financial burden predisposing them for poor payment performance over the course of their lease.

Additional Security Deposits for Renters: The 5 Best and 5 Worst States

Further analysis of the First Advantage lease data reveals significant state-by-state disparities in the average increased security deposit requirements asked of conditionally approved residents. At the national level, conditionally approved residents screened in the study were required to provide $785 in additional deposits to qualify for an apartment lease averaging $981 in monthly rent.

In addition to differences between the frequency of one month, one-and-one-half months, and two-months additional security requirements, average rent costs can exacerbate the upfront move-in costs for conditionally approved applicants. Said simply, states with higher rents and higher frequencies of additional security deposits for conditionally approved applicants present the greatest financial impediment for renters seeking quality housing.

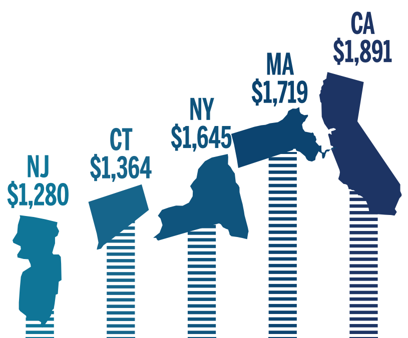
U.S. Security Deposit Requirements



ANALYSIS CONDUCTED BY NPS RENT ASSURANCE
DATA COURTESY OF FIRST ADVANTAGE

As a result, historically high rent states including California, Massachusetts, New York, Connecticut and New Jersey, were the top five "worst" states for conditionally approved apartment residents, requiring the highest average amounts of additional security deposits. With the highest average rents in the study, California also ranked as the most expensive security deposit state, requiring an extra $1,891 on average from conditionally approved residents looking to move into an apartment. Strong average rent increases in Denver pushed Colorado onto the list of most expensive states, adding $1,026 in extra security deposits for conditionally approved residents.

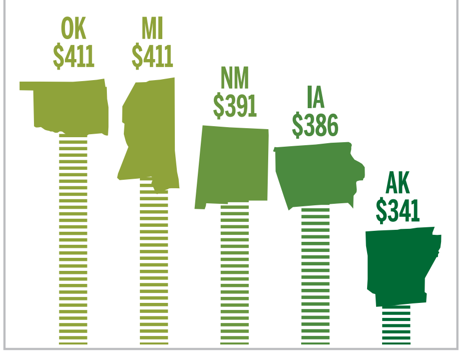
Top 5 "Worst" States for Conditionally Approved Apartment Residents



When increased security deposits were measured as a percentage of average rent, Pennsylvania, Michigan and Oregon also emerged as states with move-in requirements unfriendly to conditionally approved residents. All three states required an average additional security deposit in excess of the average monthly rent.

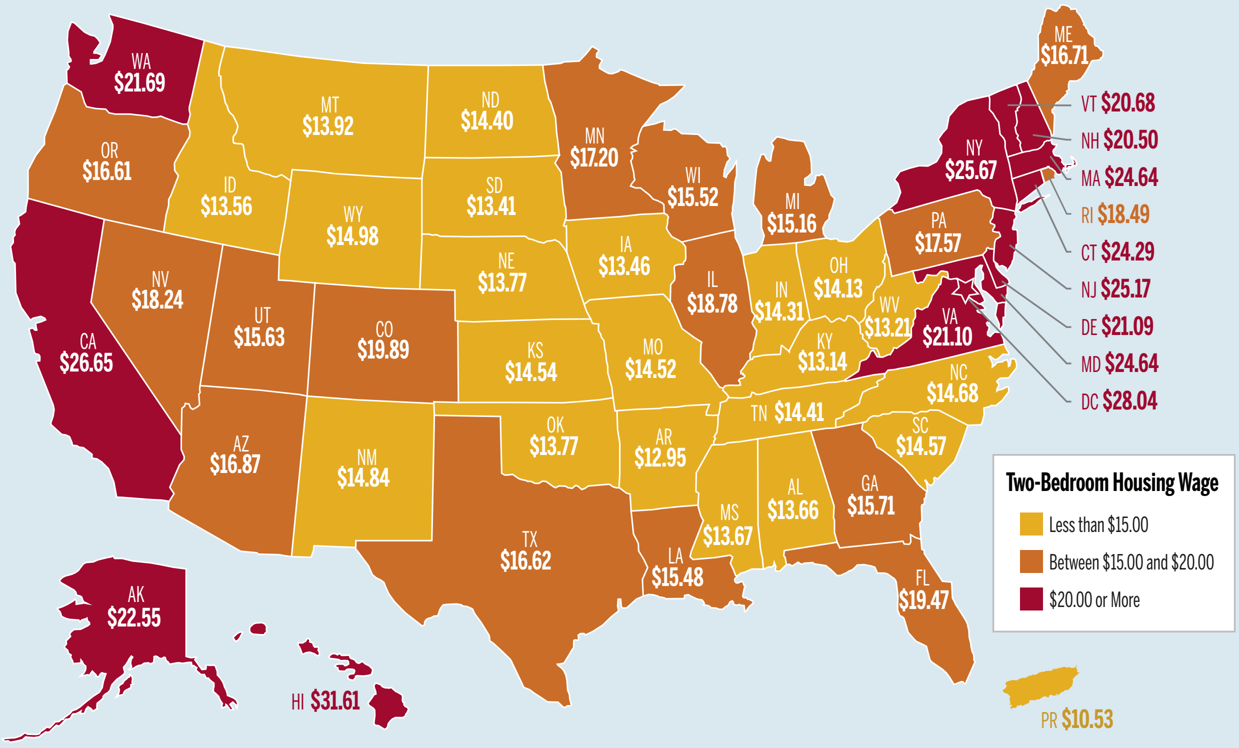
At the other end of the range, Arkansas, Iowa, New Mexico, Oklahoma and Mississippi were revealed as the top five "best" states for conditionally approved apartment renters, as measured by the lowest average dollar amounts in additional security deposits. With extremely low average rents of $603 per month, conditionally approved residents in Arkansas pay an average additional security deposit of only $341.

Top 5 "Best" States for Conditionally Approved Apartment Residents



While state-by-state average wages may seem to provide some mitigation to the average "best" and "worst" states when it comes to the cost for conditionally approved residents to move in, data from the National Low Income Housing Coalition shows that the average American household must earn at least $19.35 per hour in order to afford a modest two-bedroom apartment without spending more than 30 percent of income to rent. As a result, one in four renter households (10.3 million renter households) can no longer afford rent based on the area median income.

State by State Affordability Map



DATA COURTESTY OF THE NATIONAL LOW INCOME HOUSING COALITION

Innovations and Alternatives to the Failed Security Deposit Model

Employment status and access to automated services have provided new and more effective methods for qualifying and moving in larger numbers of conditionally approved applicants. This innovative approach eliminates additional security deposits which do not empower residents to make on-time and in-full rent payments. When combined with screening solutions, the emergence of rent from payroll is helping to identify and convert qualified conditionally approved residents using tools to assure payment performance rather than hindering residents with financially burdensome security deposits. Indeed, the "pay and pray" model of requiring additional security deposits just helps applicants qualify for a lease but fails to provide the tools necessary to deliver rent payments each month.

Rent from payroll dispenses the "all-in" mentality of requiring huge move-in deposits from conditionally approved applicants. Instead, renters agree to have their employer deposit funds into an FDIC-secured, third-party managed rent account every pay period. When rent is due, the property receives an automatic electronic disbursement to satisfy rent for every resident enrolled in the program, and residents benefit from timely rent delivery reported to a major credit bureau.

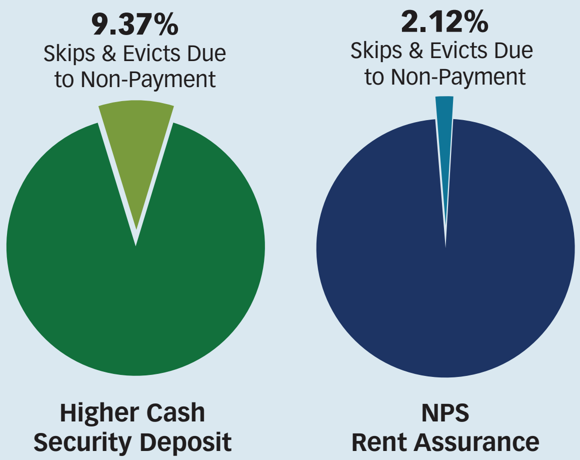
When integrated into screening solutions or as a stand-alone solution, rent from payroll provides apartment owners and managers with an alternative offer to present to conditionally approved residents. Instead of increasing the cost to move in, rent from payroll decreases move-in costs (when compared to additional security deposits) for this critical renter demographic. As a result, prospective renters can easily say "yes" to a more affordable lease option, and can demonstrate their intent to make rent their first payment priority, while property managers benefit from the increased conversion of prospects into paying customers.

According to Boston, Mass.-based rent from payroll provider Neighborhood Pay Services (NPS), the impact of offering rent from payroll as an alternative to security deposits can be profound. In a study of 6,597 conditionally approved applicants conducted in June 2014, use of rent from payroll versus requiring additional security deposits increased conversions by 57 percent on average.

After implementing rent from payroll at selected communities across its portfolio of 22,000 apartment units in Texas, Florida and New England, one study participant saw conversion of conditionally approved residents jump from 68 percent to 82 percent. At communities where conditional deposits were greater than $1,000, the rent from payroll effect was even more profound, propelling a weak 45 percent conversion to 74 percent.

What's more, residents enrolled in a rent from payroll program were more likely to renew and stay at their apartments longer, with length of stay averaging at 505 lease days. That's likely because rent from payroll essentially removes the resident from the rent payment process, consequently dropping late and unpaid rent payments (and their associated fees and costs) to nearly zero.

NPS Impact on Reducing Skips and Evictions



According to the NPS analysis of conditionally approved applicants, skip and eviction rates drop from 9.37 percent for residents with increased security deposits to a mere 2.12 percent when rent from payroll is applied — a 77 percent decrease equating to nearly 98 out of 100 additional conditionally approved residents being able to deliver on their lease obligations.

Given an industry average of $2,000 to $4,000 in vacancy loss, legal costs, and to repair, repaint and "make-ready" for a vacant unit, 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. Recent integration of rent from payroll into resident screening solutions has accelerated offer delivery even faster. With more conditionally approved residents converting more rapidly, apartment owners and managers can reduce the time it takes to fill made-ready vacancies and subsequently see reduced "days on market." According to the National Apartment Association 2015 Survey of Operating Income and Expenses, associated marketing spend to turn a unit was another $173 per apartment on top of make-ready costs.

Performance Visibility and Payment Analytics Throughout the Life of a Lease

In addition to vastly enhanced payment performance and drastically reduced move-in costs for conditionally approved renters, the combination of resident screening services with rent from payroll offers unprecedented visibility into the lifetime value of individual renters, as well as early-warning forecasting into job loss as revealed by employer deposits to rent from payroll accounts. With screening providing a historical analysis of credit worthiness and payment history and rent from payroll providing visibility into future ability to make rent payments, the resident screening / rent from payroll option provides a first ever analytical assessment of renter financial management across the entire lease lifecycle.

In particular, the cycle of employer deposits to rent from payroll accounts provides property managers with an automatic "early warning" should an issue arise with a resident's job status. Due to the regular, ongoing cycle of employer deposits each pay period, balances can be enough to cover one month's rent or more in the event of job loss. This provides both resident and apartment manager with valuable time to work out alternatives, resulting in lower rates of evictions and resident "skips."

Since rent deposits occur during every pay period, residents often have monies accrued even if terminated or laid off. In fact, at the time of job loss, for 85 percent of their rent from payroll customers, NPS has received at least 50 percent of the next month's rent; 65 percent of the time, NPS has received at least 75 percent of next month's rent, and 20 percent of the time, NPS has received 100 percent or more of the next month's rent.

In the event that a rent from payroll customer ultimately must terminate their lease due to job loss, the resulting "bad debt" balance is significantly lower than for renters who opted for an increased security deposit lease. In a sample analysis of 4,386 move-ins across one apartment community portfolio, the average bad debt on move out for rent from payroll customers was only $386, almost 50 percent less than the average $738 bad debt balance for other conditional move-outs, a stark difference that further highlights the ineffectiveness of additional security deposits to prevent and cover move out losses.

Conclusion

Requiring additional security deposits to convert and ensure the payment performance of conditionally approved apartment residents is likely an outdated practice that does little to encourage move-ins while paradoxically setting renters up to fail on their rent obligations by depleting critical financial resources at the outset of a lease.

By combining rent from payroll offers with applicant screening services, apartment owners and managers can eliminate the outdated "pay and pray" model at lease signing and instead provide a low-cost option that encourages move-in of greater numbers of conditionally approved residents while providing them with hassle-free financial management tools that prioritize rent as a scheduled, reliable monthly payment. The result is greater security for apartment owners, managers, and renters alike without the false security that paying more in upfront conditional deposits can realistically provide.