



## WHITE PAPER:

# Using Technology to Manage Risk for the Independent Rental Owner

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### Introduction

Managing risk is the most critical process for the independent rental owner and manager for ensuring profitability and achieving the highest net operating income (NOI). From small apartment properties to firms with large portfolios, management has focused on reducing operating costs and increasing the efficiency of property management processes.

So risk for the independent rental owner (IRO) can be defined as delinquencies, evictions, resident turnover, bankruptcy fraud, potential litigation and liability issues -- all of which can significantly impact the bottom line for apartment communities, drain revenue from income and adversely affect property values.

When you consider that apartment industry experts report that the industry loses \$4 billion annually to bad debt, the importance of risk management becomes clear.<sup>1</sup>

Using methods, such as resident screening, criminal background checks, and improved payment and collection procedures, have proven successful in mitigating the damage these factors can cause and lowering the cost of bad debt, float and collection. Traditionally, these methods were done manually, involving paperwork, phone calls, faxes, and decision-making by onsite staff.

For independent rental owner and managers with limited time and staff resources, automating key property management processes can reduce operating costs, boost efficiency, and minimize errors from data entry and manual, paper-based processes.

### **Web-Based Property Management Solutions**

Within the past decade, the apartment industry has leveraged technology to improve processes, streamline workflows and gain better control of all aspects of property management. This has been achieved mainly through the introduction and evolution of technology, primarily built around property management software.

The first systems in the industry were mixes of DOS-based accounting and rent-roll systems that often proved inflexible and difficult to learn and use. These systems were also limited in their ability to import and export data and were fraught with compatibility issues. In what now seems the dark ages before the Internet and the rise of apartment REITs, compatibility was not a crucial issue. Stricter reporting requirements from the financial markets and investors have made broad compatibility and ease of access to data a necessity. Further, more sophisticated revenue management and marketing, such as over the Internet, have increased the value of data and speed of access.

Next in the evolutionary chain of property management software was the transition to Windows-based software. This allowed for increased functionality, greater ease of use, and simpler deployment. The Windows platform also allowed developers to customize their applications for end users to a degree impractical on the DOS platform.

These Windows-based applications grew to include diverse components or modules covering all aspects of property management: accounting, marketing, lease management, payment and collections, financial management, maintenance management, financial modeling, and communications.

The advent of the Internet and its explosive growth as a pervasive communications and e-commerce medium has led to the migration of property management software to the Web, with the latest software developed on the Application Service Provider (ASP) platform. Essentially, this means applications are hosted on the service provider's, or developer's, servers and accessed over the Internet through the users' web browsers.

Web-based applications and ASPs together offer a number of advantages over traditional formats. The software is easier to learn and use and significantly easier to manage and maintain. Web-based applications and ASPs together create a web-based solution as a service for the independent rental owner and reduce the financial impact of technology on the company.

Many of the first web-based property management systems to appear on the market were applications ported from older platforms to the web. One of the first companies to develop a Web-based property management system for the web built from the ground up is DIY Real Estate Solutions. This system, run solely on the web and accessed through a browser, comprises a comprehensive property management system tailored exclusively to independent rental owners and managers with 1,000 or less units in their portfolio.

DIY Real Estate Solutions provides complete functionality for managing resident information, leasing and lease management, service requests, financial transactions, add-on credit and criminal screening services accessible from within the system, and a wide range of reporting features. A key advantage to DIY's system is access by the owner or

manager to real-time data and intra-system feedback that notifies the users of critical issues and impending deadlines for transactions and service orders.

Prior to the emergence of Software as a Service, such as DIY's, small to medium-sized owners were locked out of the benefits of high-end property management software due to cost and complexity. The new Software as a Service levels the playing field for independent rental owners and gives them a competitive edge that allows greater control over their properties, access to real-time data, ability to respond more quickly to market changes, and, perhaps most importantly, gives them the most complete and current status of their property available.

## **Resident Screening**

Given the potential downside to NOI from bad debt, careful selection of prospective residents is the most useful tool available to owners and managers. Making informed decisions about new residents can reduce bad debt, maintain occupancy levels and provide a consistent application process compliant with Fair Housing and Fair Credit regulations. Compliance is crucial for smaller owners who can be ruined by lawsuits or regulatory action. Without a viable approach for dealing with bad debt, owners and managers spend too much time chasing after uncollected funds and lose too much money in the process.

Our own surveys and experience with independent rental owners is that the two most formidable and widespread challenges they face are vacancies and "bad" residents. A poor choice of a resident can produce much more than a collection headache. Bad residents can cause severe damage to property, harm other residents, create time-consuming and costly litigation and liability cases and even affect your property's reputation within the community.

The best weapon in the apartment owner's arsenal is credit and resident screening. The first part of any resident screening is a credit check and the most sophisticated method for credit checks is also known as credit scoring. Credit scoring has been around for nearly 50 years. It began as a fact-based, statistical method for assessing the risks posed by a given consumer related to financial obligation. First developed by the Fair Isaac Company, the most common credit scoring became known as the FICO score and was initially used by retail companies.

Today, credit scoring is ubiquitous and is used by banks, finance companies, mortgage companies, credit card issuers and the auto industry. Credit scoring is endorsed by the Federal Trade Commission as a methodology that benefits consumers and provides more objective, faster and less costly credit decisions than traditional subjective systems.

The growth of technology and development of broad statistical databases led to the automation of credit screening which has enabled easier access and has given landlords the ability to render credit decisions on the spot.

While credit screening has been around for some time and is now considered a proven system, the apartment industry has only embraced it broadly since the mid to late 1990s. Prior to that, credit checks were all done manually, using rules of thumb and inconsistent methods. With credit scoring, automation and improved communication via the Internet, the task of a credit screening check has gone from a manual process that took several days to weeks to one that takes less than a minute online.

Another advantage to automation of resident screening is that it simplifies the process and better enables owners and managers to interpret the complicated data on a credit score report. This allows them to act on the information with greater confidence. Because the system is web-based, decisions are made faster and allow faster service to prospective residents.

DIY Real Estate Solutions offers resident screening from within the program through its partner Transunion Credit Retriever, based in Greenwood Village, Colo. And parent firm Transunion based in Chicago. Credit Retriever Resident screening gives the independent rental owner real-time access to:

- Access current data from all three major credit bureaus
- Identify the best applicants without decreasing occupancy rates
- Gain more time for marketing and activities that enhance resident satisfaction
- Ensure compliance with Fair Housing and Fair Credit laws
- Ability to model; results for individual communities
- Ability to accept, deny or accept residents conditionally case by case

## **Scoring Models**

Today's credit screening is both a service and Point-of-Transaction process essential to protecting profitability. According to Michael Britti, chief executive officer of Credit Retriever and an expert on credit scoring technology, "Some 80 percent of measurable and controllable risk is decided on at the time of application."

Various scoring methods use statistical scoring models gleaned from renter payment histories, financial databases and credit bureaus, rules-based decision systems and artificial intelligence to assess risk and enable credit decisions.

As more information is gathered and shared by financial institutions, credit card companies, landlords and industry associations, more precise risk models can be developed and utilized.

Apartment credit scores are developed from the universe of renter data as opposed to generic credit scores for the general population, the majority of which are homeowners. As a result, apartment-based credit scores are more accurate and more predictive of renter behavior and the likelihood to cause losses to owners due to unpaid rent, property damage, or evictions.

"From one easy to use source, you can confidently predict payment performance, search the industry's largest criminal database, view insightful reports and improve your collections efforts," says Britti. "TransUnion Credit Retriever gives you the tools to make better decisions at every stage of your tenant lifecycle: marketing, selection, residency and collections – all from within applications such as DIY Real Estate Solutions or as a standalone service."

## Resident Payment History

A byproduct of the massive collection of credit and renter performance data developed over the past decade has been the broader availability of actual data on renter payment histories. As this data is shared and aggregated, the ability for owners and managers to make decisions on prospective residents is greatly enhanced.

One of the many innovative features in DIY Real Estate Solutions' web-based property management system is its ability to collect and maintain data on residents' payment histories and provide owners-managers with up-to-date reports on these payment histories. If the client using the DIY system approves, the resident payment history data can be submitted electronically to Credit Retriever. As more owners use these web-based reporting systems and share data, the resultant database compiled will be a powerful tool for predicting rental payment behavior.

In addition, renters have a strong incentive to pay their rent on time, which is especially important to smaller and medium-size owners. Before our patent pending innovation, rent payments were not part of a renter's credit report. They therefore had little concern about not paying on time, other than late payment penalties. DIY and Credit Retriever have made rent part of a consumer's credit report and therefore benefits those who pay on time and penalizes those that don't.

## Criminal Background Checks

Increased liability exposure and post-9/11 concerns have made criminal background checks an essential element of apartment property management. In addition to liability and potential damage to property and residents, the presence of individuals with criminal histories at an apartment community can generate negative publicity and spark turnovers.

### **Recent Department of Justice Statistics you may not want to know:**

- Nearly 5 million adult men and women are on probation or parole
- Half those on probation had committed a felony and half misdemeanors
- Almost all offenders on parole had served more than a year in jail or prison<sup>2</sup>

Through use of providers such as Credit Retriever, apartment owners can review the backgrounds of any prospective resident and receive immediate feedback via the web on any potential criminal records or activity.

"Our criminal background checks search one of the multihousing industry's largest criminal databases instantly and we can provide data from every county in every state," states Michael Britti of Credit Retriever.

Criminal background checks automatically search state department of corrections records, court records, department of public safety records, and sex offender registries. There is also an automatic database search of terrorist records. Additional databases searched by Credit Retriever include:

- Multi-State Sex Offender Search
- Office of Foreign Assets Control
- FBI Most Wanted
- U.S. Marshals Office
- U.S. Alcohol, Tobacco and Firearms
- U.S. Customs
- U.S. Secret Service
- U.S. Drug Enforcement Agency

Again, because automated criminal background checks follow consistent, verifiable methods, compliance with Fair Housing regulations is ensured.

## Collections

An executive of a large apartment firm in the Midwest stated, "Uncollected rent amounts to a loss of about 1 to 2 percent of annual revenue and when we're looking for 3 to 4 percent growth in a year, that hits hard."<sup>3</sup>

One of the more problematic areas for owners is the collection of bad debt. Not only is recovering bad debt time-consuming and costly, it presents problems with tenant relations and meeting the vast array of requirements of federal and state collections practices.

According to the Commercial Collection Agency Association (CCAA), the longer a debt goes unpaid, the less likely the debtor will pay what is owed. Compounding the problem is the fact that multifamily debtors – tenants – often lack substantial equity or assets to attach to recover those debts. Also, the transient nature of apartment residents makes them harder to track down and contact.

The major change to the collections industry in the past 15 years, maintains the Association of Credit and Collection Professionals, is the move to automated collection practices. Computer technology has led to better recordkeeping and access to databases has made it easier to locate debtors. Improved communications systems have also made it easier to share information with clients of collection agencies.

Another valued partner for DIY Real Estate Solutions is NCC Business Services, a firm based in Jacksonville, Fla. with expertise in collections for the multifamily industry, nationwide.

In the information age, clients profit greatly from having real-time access to their files and electronic information. Working with NCC Business Services allows clients to leverage the Internet to their advantage. Status reports, portfolio reports, and acknowledgement reports are readily available through multiple channels via fax, automated emails, and online viewing. These services, in addition to their informed and helpful support personnel, are available via traditional phone support, as well.

"NCC's diverse range of customer support methods allow for quick and complete answers regarding your accounts," says John Gray, National Sales Director for NCC Business Services. "This streamlining of issue handling allows NCC to offer customized services for the client that desires more than the standard industry offerings. Customizing reports to meet a particular need and offering consulting services to streamline internal policies and procedures are two examples of the extended services NCC is able to offer our clients."

"Investing heavily in technology, NCC has implemented a paperless management system that is completely web-enabled," adds Gray. "By utilizing the latest scanning technologies, a 'best-practice' managed network, and the power of the Internet, NCC makes interaction with their clients and former residents more efficient than it has ever been. Equally important is the fact that our clients have access to their portfolio's performance via automated emailed reports and/or on the Internet at [www.nccbusiness.com](http://www.nccbusiness.com)."

NCC's dedication to technology and client-centric services warrants the use of completely redundant systems. These systems are designed for maximum uptime with no loss of data and complete data security. From utilizing national databases to locate debtors to providing clients 24 hour a day/7 day a week access to their reports via the Internet, NCC Business Services exemplifies the advantages independent rental owners can gain from utilizing an automated collections system.

## **Conclusions and Recommendations**

Careful observation and analysis of past trends in resident behavior in the apartment industry demonstrate that successful risk management is the key to maintaining profitability, reducing operating costs and limiting the adverse effects of bad debt.

Certain facts remain unchanged. There will always be "bad residents" who evade paying rent, cause property damage or create legal crises. Human behavior will not change because new technologies have been developed. Nor will economic cycles that can stress individuals' ability to meet their financial obligations cease.

The critical factor in addressing risk is information. The more information the independent rental owner has about the status of their properties and residents, the better decisions they can make. Merely having more information is not sufficient. Two factors determine the value and actionable nature of information – *quality* and *timeliness*. As the saying goes, old news is no news. The key to obtaining this information, or business intelligence, is property management applications and related services (such as resident screening and collections) that provide real-time data that is accurate and in-depth.

For the first time, independent rental owners have the opportunity through use of innovative, web-based property management solutions to manage risk, enhance performance and respond immediately to market conditions on a par with larger firms.

Web-based services serve to seamlessly integrate the critical functions needed to manage properties profitably. Technical innovation has made this functionality affordable, easier to use and simpler to deploy.

## **About the Author**

Russ Sandlin has been involved with the multifamily industry for over 30 years. He has worked with conventional and independent owners throughout the United States and internationally. A long-time member of the National Apartment Association and a noted industry consultant, He lectures frequently at industry conferences. He is presently Vice President of Marketing for DIY Solutions Inc., based in Hudson, Ohio. You can reach Russ at [rsandlin@diyresolutions.com](mailto:rsandlin@diyresolutions.com). The company's web site is [www.diyresolutions.com](http://www.diyresolutions.com).

## **End Notes**

- <sup>1</sup> *Units*, July-August, Kim Fernandez, National Apartment Association, 2001
- <sup>2</sup> *Multifamily Trends*, Barry Kipnis, Summer, Urban Land Institute, 2001
- <sup>3</sup> *MultiHousing Professional*, September, Professional Image Publications LLC, 2006
- <sup>4</sup> *Apartment Professional*, Stephen Sobota, Real Estate Communication Services, September, 2005

## **Resources**

DIY Real Estate Solutions Inc., [www.diyresolutions.com](http://www.diyresolutions.com), 866-602-9007  
Credit Retriever, [www.creditretriever.com](http://www.creditretriever.com), 888-966-8607  
NCC Business Services, [www.nccbusinessservices.com](http://www.nccbusinessservices.com), 888-880-6020