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Effective Coverage • White Paper

Resident Risk Management For CFOs:

Where To Allocate Funds

Executive Summary

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Few things change the financial health of a company like a targeted program designed to mitigate risk and increase profitability. Effectively managing the deployment, ongoing administration, and cash flow of such a program frees up the executive team to focus on essential tasks.

This paper will focus on understanding the financial building blocks and ongoing management of a comprehensive resident risk management strategy designed from the ground up to meet the needs of multifamily and single-family portfolios.

Historical Review: A Comprehensive Analysis

√ **Losses** Successful program design should start with a five-year loss history. How impactful have occurrences resulting from resident negligence been?

√ **Subrogation** Has effective subrogation against policies secured by residents been obtained?

√ **Renters Insurance** The average price of renters insurance is $188 annually. A best practice is to include the cost borne by residents for complying with lease requirements.

Framing The Future: Program Design

√ **Fee Management** The most successful programs combine a three-part approach to resident risk management; renters insurance, certificate management, and fee management. Then the decision must be made on where to allocate fee income; loss fund, captive solution, or master policy.

√ **Fee Allocation** When your solution involves driving money to a captive or loss fund, proper allocations of funds to support your historical loss rates are critical.

√ **Operational Considerations** Lease wording, certificate tracking, deployment across a portfolio, training, and marketing, are all fundamental for a resident risk management program that is successful and profitable.

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Resident Risk Management Costs

Essential to the resident risk managment effort is the generation of fee income and a detailed plan for the allocation of those funds.

Research Expenses

Careful research and in-depth risk analysis of the past 5 years must be conducted before starting a new program. Some business owners choose to hire market research firms to aid them.

Subrogation

If you have been requiring your residents to maintain insurance, it is likely that some of the resident-caused costs identified in your historical review were recouped through subrogation.

Renters Insurance

The national average price of renters insurance is $188 annually, according to the 2016 study by the Insurance Information Institute.

Marketing & Implementation

A successful marketing and implementation plan is much more than a brochure in the leasing office. It also includes training, customized technology, and resident awareness campaigns.

Loss Fund

Starting a resident risk management program requires careful cash flow management. The creation and proper allocation of funds is a critical component for managing long-term success.

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Historical Review: A Comprehensive Analysis

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The first step in designing a successful resident risk management program is to perform an in-depth historical review and risk analysis. Looking through the lens of the past provides guidance and sets the standard for what worked, what didn't, and what is needed.

Losses

Resident negligence can come in many forms, but the most common type falls under "Property Damage to Rented Premises" coverage. The frequency of these resident-caused loss events is alarming. The most common type of loss is a kitchen fire, resulting in water and smoke damage. These loss events impact portfolios in two main ways:

- Deductible Retention Your deductible must be paid prior to your commercial insurance responding to any loss. If you have a $10,000 deductible, the per-occurrence impact at the property level would be $10,000. If you have 3 negligence events over the course of the policy year, the total expense would be $30,000.

- Increased Property Premiums Increased frequency, supplemented by low carrier deductibles, result in higher ongoing insurance premiums. Has the frequency or severity of resident negligence claims had a significant impact on your commercial premiums over the past 5 years? What about reputational risk, lost rental income, and uninsured expenses?

How much have...

...your renters spent on renters insurance?

...you been reimbursed through subrogation?

...you spent tracking certificates of insurance?

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Subrogation

Subrogation is often thought of as a tedious, time-consuming, and complex process between insurance companies. In reality, subrogation against a renters insurance policy is often quite effective. Unlike commercial disputes which can drag on for years, renters insurance subrogation is completed directly between the landlord and the resident's insurer. This is especially straightforward when the landlord has the resident's policy information and policy status is confirmed prior to any loss.

However, the simplicity of the renters insurance subrogation process can also mean a lack of coverage is just as readily available. A landlord's presumption that coverage will be afforded under the renters insurance policy does not always meet with reality. Policy wording, care custody and control exclusions, and difficulty in determining resident negligence are all part of the problem. This is why fee management is an excellent way to financially prepare for the inevitable.

Renters Insurance

According to the 2015 study by the Insurance Information Institute, the national average price of renters insurance is $188 per year.[1] Over the past decade, the vast majority of professionally managed properties have updated their lease requirements to mandate renters insurance. This initiative was driven to manage the costs of resident negligence.

When completing your analysis of the value of your resident risk management solution, it is imperative to include the cost borne by residents to comply with the lease requirements. For example, residents living in a 10,000 unit portfolio spend a combined total of about $1,880,000 in renters insurance.

After conducting a thorough historical review and analysis, you may find that your current resident risk management program is lacking. Developing the right solution for your portfolio lies heavily in this analysis.

Below is a worksheet to help you understand your costs. What do your figures show? Is the cost greater than the benefit?

[1] "Average Premiums For Homeowners And Renters Insurance, United States, 2006-2015," The Insurance Information Institute, n.d. https://www.iii.org/fact-statistic/facts-statistics-renters-insurance, (accessed) 22 Oct. 2018.

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Cost Benefit Worksheet

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Resident-caused claims	-
Insurance certificate management	-
Total cost of renters insurance	- $188 x unit count*
Costs	
Subrogation	+
Marketing Fees / Ancillary Income	+
Revenue	
Total Benefit	

*The average cost of renters insurance is $188/year. This increases the cost of living at your communities, and is therefore considered in your resident risk management expense. Number of units x $188 = expense.

Framing The Future: Program Design

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Management of the resident risk problem is complex, full of regulation and potential insurance coverage holes. Insurance is regulated on a state-by-state basis which makes compliance extremely challenging to enforce. Compounding the issue, the resident is often a reluctant participant in what they perceive to be an unnecessary tax.

However, resident risk management is a necessity for every professionally managed portfolio. How to build an ecosystem that protects the residents, the apartment owner, and provides a positive cash flow stream for the properties is available today

Fee Management

Accurate financial reporting, financial projections, building and maintenance of the financial model are all pieces of the resident risk management puzzle. Many apartment owners reach a scale where offering the resident a choice can build an additional profit center.

This choice is to pay a monthly charge in addition to rent directly to the property, instead of to an insurance company. We have seen loss funds reach into the millions and give apartment owners the chance to have better clarity and control when it comes to paying for losses that fall under the deductible of their commercial insurance programs.

Best Practices For Fee Management:

- Offering residents a competitive insurance policy in lieu of the fee.
- Communicating with the resident, regarding their decision to not maintain insurance.
- Properly allocating funds to ensure adequate protection in the event of a loss.

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Fee Allocation

The creation of a fee program can greatly assist in numerous ways, including establishing a captive, purchasing a master policy, capitalizing a loss fund, or increasing the profitability of an asset.

Options for aggregating the fee revenue include:

- Captives Separate off-balance sheet entities that allow owners and managers the ability to consolidate funds across the portfolio. Certain complexities do exist when considering captives. For example, when your solution involves driving money to the captive proper contractual agreement between the captive and the diversified properties must be established.

- Traditional Reserve One of the easier approaches to consolidating the funds across the portfolio and capitalizing on your economies of scale is with a reserve fund allocated in a bank account or entity. Loss reserves are typically calculated as ordinary income and left to be utilized in the event of a significant loss.

- Property-Level Retention The easiest of all solutions is to keep funds charged at the property level. This has the benefit of increasing the financial performance of the portfolio. However, the concern is that no one property will collect enough funds to effectively manage the entire risk.

- Master Policy Based On Monthly Bordereau Some clients prefer to mitigate risk and the volatility associated with retaining the loss fund. Excellent carriers exist with products designed to collect the funds for residents who do not maintain traditional insurance.

Fee Program

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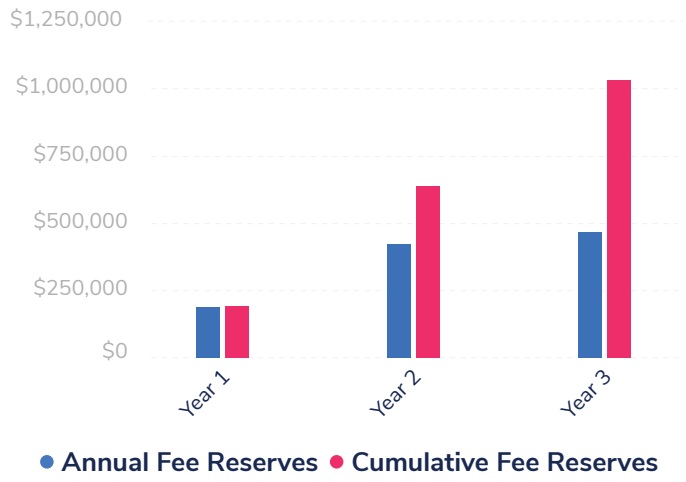
Pro Forma Based On 10,000 Units



4,500
Residents enrolled in fee

$224,000
Year 1 resident fee reserves

$453,600
Year 3 annual fee reserves

$1,109,600
Year 3 cumulative fee reserves

Many owners reach a scale where offering the resident a choice can build an additional profit center. Structuring a fee program for those residents who chose not to purchase insurance can be an excellent method to increase portfolio performance.

This choice is to pay a monthly fee due in addition to rent instead of to an insurance company.

Operational Considerations

Besides the hard numbers, there are many nuances for a successful deployment and restructuring of your resident risk management program.

Items to consider include lease wording, certificate tracking, training, ramp-up for deployment, variations across a portfolio, marketing materials, and overall program design and structure.

We have seen fee program revenue reach into the millions and give owners the chance to have better clarity and control when it comes to paying for losses that fall under the deductible of their commercial insurance programs.

Conclusion

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Mandating a resident risk program that combines a historical review of losses, subrogation and renters insurance history with an effective program design ensures your commercial insurance policy won't be impacted unless there is a truly catastrophic event.

Tenant-caused damages can be a huge setback to your commercial insurance program, and take a minimum of 5 years or more to repair. Formulating an effective management plan at scale means knowing when to implement insurance compliance, when potential problems may occur, and what to when catastrophe strikes.

Having a program that provides 100% transparency is the best way to manage the insurance compliance life cycle for real estate portfolios of scale, from the day the resident is approved, until they move out.

How do you mitigate risk while increasing profitability?

About Effective Coverage

Effective Coverage provides a unique resident risk management solution for real estate operators seeking increased profitability and full lease compliance.

The firm was founded with great respect for the value that experience and focus brings to the business. Our principals possess deep expertise in the insurance industry, which has allowed us to deliver best practices with a high level of individualization. This leads not only to our success, but also to that of our clients.

Learn more about our company and history at www.EffectiveCoverage.com/thought-leadership

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Notes

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Version 5.30.19