The Value Proposition of Renters Insurance for Apartment Firms

Survey Data, Case Studies Have Implications for Multifamily Industry

The Spanish Gate apartment fire, Glendale, Colorado, December 2003.

Joshua Tree Consulting
436 14th Street, #810
Oakland, CA 94612
(510) 444-2988
www.joshuatreeconsulting.com

Stephen Lefkovits
Joshua Tree Consulting

May 2006

"I begin to think that it is safer for me to dwell in the wild Indian country than in this stockade, where fools accidentally discharge their muskets and others burn down their homes at night."
Captain James Smith, Jamestown Settlement, Virginia, 1608

The National Fire Protection Association estimates today that there are approximately 95,000 fires in multifamily buildings each year. 70% of all fires are caused by residents' negligence. Although renter's insurance covers theft, water damage, liability and provides numerous benefits to property owners and insured renters, fundamentally, renter's insurance—and all property insurance for that matter—is a security blanket against the sudden loss of all of one's possessions in a fire.

Historically, insuring one's self from fire dates back 300 years and was spurred by the closeness of urban living. The first fire insurance company was formed in rapidly growing London in 1710. In the United States, Benjamin Franklin's Philadelphia Contributorship for the Insurance of Houses from Loss by Fire was founded in 1752. Those families with insurance counted on the insurance companies to save the value of their possessions by carrying them out of the burning home.

This White Paper

A volatile insurance market has led many apartment firms to take back significant amounts of risk in order to manage their insurance costs. Yet, many firms overlook the hidden risk of uninsured renter's by not requiring residents to obtain renter's insurance.

This White Paper analyzes the cost to apartment firms of uninsured renters using a variety of sources, including: national loss data; claims data from LeasingDesk, an insurance provider; the American Insurance Association; the National Multi Housing Council's (NMHC) 2004 Cost of Risk Survey and interviews with property owners. It also examines the impact of requiring renter's insurance on leasing success using a 2005 survey conducted by Satisfacts Research, LLC and a 2005 survey of 1,073 residents who are insured by LeasingDesk Insurance's eRenterPlan.

Disclosure

This white paper was sponsored by LeasingDesk Insurance Services.

Joshua Tree Consulting
436 14th Street, #810
Oakland, CA 94612
(510) 444-2988
www.joshuatreeconsulting.com
steve@joshuatreeconsulting.com

White Paper Executive Summary

Renter's insurance offers apartment firms significant financial value at no cost.

- **Renter's insurance shifts the financial liability for resident-caused accidents** from the property owner to the resident by covering the cost of such losses below the property owner's property insurance deductible or retained risk. An expected-loss model created by Joshua Tree Consulting estimates that renter's insurance provides multifamily property owners with approximately $110,000 in expected financial benefit annually per 20 properties owned (250 units per property average) –at no cost to the property owner. (See appendix. Model based on the average deductible of $25,000 and the average retained risk of $125,000.)

- **Renter's insurance also covers the cost of repairs necessitated by resident-caused accidents instead of requiring property owners to cover them** in their property maintenance budgets. Property owners that require residents to carry renter's insurance spend, on average, 45% less on accident-caused repair and recovery expenditures than firms that do not require such coverage. Therefore, requiring resident insurance coverage can significantly increase net operating income (NOI).

- A recent survey by LeasingDesk shows that apartment **executives who require insurance strongly agree that it reduces their risk exposure**. Fully 83% recommend the program to other executives, and 91% say that the LeasingDesk program is "easy" or "manageable" to administer.

- In the event of a covered catastrophe, renter's insurance provides rapid monetary relief to a large number of residents. This may enable them to remain renters within the owner's property or portfolio after an incident, further improving the properties NOI after a disaster.

Contrary to conventional wisdom, requiring renter's insurance does not put apartment firms at a competitive disadvantage. In fact, it can help improve customer satisfaction levels.

- **Firms that require renter's insurance say it does not adversely affect their ability to lease apartments**, even in competitive markets. Indeed, many residents view it as an amenity and are thankful for coverage when they understand that it protects them from circumstances beyond their control, such as other resident's accidents.

- Residents also value coverage of stolen items–the most frequent kind of resident loss. Having renter's insurance in place when losses occur saves money, reduces time-consuming disputes and eliminates conflicts between owners and residents, all of which can directly affect resident retention and customer satisfaction levels.

- Renter's insurance also offers renters who have experienced a catastrophic loss with the means to restart their lives after the Red Cross, Salvation Army or other relief agencies have provided emergency assistance.

The Risks of Uninsured Renters to Property Owners

Uninsured renters are not only a financial risk to apartment owners, they are also a liability too, and they represent an administrative burden to property managers. Fire, accidents, theft and disasters happen. When they happen to renters with insurance, the renter is financially protected. If the incident is resident-caused, the owner is also covered since they have an opportunity to make a claim to the renter's policy to cover property damages that are less than the property's own insurance deductible.

Potential Claims from Uninsured Renters

- Fire
- Theft
- Leaks
- Replacement living quarters
- Earthquake
- Slip and fall

When renters are uninsured; however, the owner has no financial recourse to repair property damage—other than from the property's own cash flow. In other words, renter's insurance reduces unscheduled, event-related property repair costs. According to a 2005 survey, properties that required renter's insurance reported, on average, 45% lower resident-caused losses than those that do not require renters to carry their own insurance.

Subrogation Manages Risk

Subrogation is an insurance law concept in which a party required to pay for damages (the property owner, for example) is allowed to seek payment from the person legally liable for the injury or property damage (the resident of the resident's insurance company). Assuming that subrogation, which is regulated by state law and typically governed by the lease terms, is permitted, and a resident has renter's insurance, this can be an valuable risk management tool to minimize accidental or catastrophic property losses.

Property Insurance by the Numbers

- 95,000 multifamily fires annually
- Typical deductibles: $10,000–25,000 per occurrence per property.
- Typical SIR: $125,000 per property.
- Average loss (under deductible) for repairs per property: $1,932.
- Median largest covered property claim per property: $234,000.
- One small claim incident (under $25,000) per two properties annually.
- One large claim incident (over $25,000) per 17 properties annually.

Subrogation occurs primarily between insurance carriers, but property owners that self-insure a portion of their risk can manage the subrogation process for their retained risk themselves. If a property owner requires renter's insurance and has an updated record of every resident's insurance carrier, it is relatively easy to subrogate a claim for resident-caused damages. In other words, requiring renter's insurance substantially helps property owners manage a self-insurance program by creating a deep pocket behind every resident that has a process for claims and the means to pay them.

Estimating the Liability of Uninsured Renters

Joshua Tree Consulting has created an expected loss-model (see appendix) to determine the financial value of renter's insurance to property owners. According to that model, which is detailed below, requiring renter's insurance provides the apartment portfolio owner with about $110,000 in expected financial benefit annually for every 20 properties owned. (This estimate assumes that applicable deductibles and self-insurance retained are at least the amounts described below, and that there are no administrative, legal or owner-paid resident transition costs for the owner. Users may find that by factoring in these costs, the financial value to them is significantly higher.)

When a disaster occurs, a property owner is liable for their per-occurrence deductible as well as any aggregate deductible that must be met. Deductibles differ from retained risk. For property owners with self-insurance risk retention (SIR), the financial liability is the amount of the retention, plus the legal costs to defend the company, and the cost and time to administer the claims process. Owners with self-insured risk retention may also find themselves at odds with their own insurers over which strategy and tactics to use in their defense. (The different levels of liability often dictate conflicting views.)

The Magnitude of Losses

Property owners typically face two kinds of losses—large losses beyond their deductible and small losses within their deductible. (The Joshua Tree Consulting model uses $25,000 as the average per-property deductible as established by NMHC's 2004 Cost of Risk Survey.)

Small Losses (Under $25,000)

Within the deductible amount, uninsured renters often make claims to their landlords when they are victims of fire, theft, leaks and other damaging events. While owners can deny these claims, the real risk to the owner is that their property has been damaged and now must be repaired. According to the Satisfacts 2005 survey, these small claims occur at 47% of properties annually, and result in an average of $1,932 in property damage per occurrence.

Large Losses (Over $25,000)

In addition to small losses, property owners must anticipate larger losses in their risk management models. NMHC's 2004 Cost of Risk Survey estimates that the median of the largest covered property claims beyond a property's 25,000 deductible was $234,000. The survey does not provide an average loss per incident or per company however, so we inferred one by averaging the lowest possible loss ($25,000), with the largest median loss, and the median number of large losses per company (four). This yields an average large loss of $77,250. (Note: Data estimates of the actual average large claim are not available. As a result, our model may underestimate the expected value of the losses if the actual average loss is higher.)

Applying the Loss Value Model

Even with the NMHC-provided data on large- and small-loss liability, it is difficult to estimate a reliable annual "expected value" of the liability. One major incident can dramatically affect the outcome. In addition, events are not random and cannot be definitively estimated using simple expected value calculations based on frequency and magnitude. For example, 70% of apartment fires are caused by resident negligence. But, safety programs, building materials, climate, sprinklers and resident demographics can all affect the loss experience. Actuaries spend long hours underwriting non-random factors to determine expected losses.

With that disclaimer, however, we present a simple expected value model in the appendix to help property owners estimate their own expected liabilities based on average experiences across the United States. Readers can generate a summary expected loss number by entering the number of properties in their portfolio.

This exercise enables firms to analyze the value of additional insurance coverage for a portfolio. A property's exposure is the greater of their expected loss **or** the amount of risk they retain in deductibles, SIR and administrative costs. (Note: Claims administration and legal costs run about 20% of claims paid out.)

> **Joshua Tree Consulting believes that further industry-wide study and cooperation is required to definitively and actuarially estimate the true liability to property owners of uninsured renters.**

***

Case Studies

Although fire is not the most common cause of loss to a renter or property owner, fire claims are the most expensive property claims. Therefore, case studies of fire-related losses are an instructive place to begin looking at the value of renter's insurance.

The following case studies illustrate several key points when considering the value to both residents and property owners. Renters with renter's insurance:

- Are more likely to have the financial wherewithal to continue to rent from the property owner after a covered event;
- Are less likely to need free rent or other financial assistance after a catastrophe;
- Are less likely to file a frivolous claim against the property owner for loss; and
- Provide the owner with a meaningful opportunity to subrogate property losses and recover property damage without recourse to the owner's self-insurance or policies in force.

Case Study 1:
Uninsured Renters and the Spanish Gate Apartment Fire, Glendale, Colorado

In 2005, apartment resident Blake Fieber testified that while drunk and under the influence of drugs he lit a fire while smoking in bed in his unit. The resulting fire burned the entire 59-unit Spanish Gate Apartments to the ground. Fieber pleaded guilty to criminally negligent homicide and arson and is serving a six year sentence.

Drake Powell, Senior Vice President of Baron Properties of Greenwood Village, Colorado, owner of Spanish Gate, offers this review of the tragedy.

***

The Spanish Gate Fire: 59 Units 100% Destroyed

> "At the end of December 2003, one of our residents had a suspicious fire. Instead of dealing with it, he left his unit, and it ended up burning down the entire building. The building was essentially destroyed, and half of it just disappeared. It looked like the Oklahoma City bombing. One woman was killed, another was in serious condition for a week, and 55 residents from the 59 apartments were displaced."

The Spanish Gate fire aftermath, seen from adjacent building. Photo © Evan Semon.

Families Sheltered Through Disaster Relief

> "The residents were awakened in the middle of the night and left with only the clothes on their back. The Red Cross set up a shelter across the street in a gymnasium. Some people stayed there overnight. We [Baron Properties] paid for everyone's hotel rooms for more than a week."

> "Because of the severity of the fire, our residents got a lot of community support. People donated money, food and clothes. A furniture store even donated beds. We [Baron Properties] ended up relocating people to other

communities we manage, gave them a free month's rent and kept rents at the new properties at the same level. Under the circumstances, we did a great job of trying to take care of people so that helping our residents never became acrimonious."

Starting Over With Nothing

"Unless they had savings, our residents started over with nothing. There was only one person with renter's insurance. That resident had an adjuster inspect the damage and a check was cut the next week."

Renter's Insurance Now Mandatory at Baron Properties

"After the fire we researched it and ended up making renter's insurance mandatory. We worried that making it mandatory would hurt our ability to lease competitively in the soft Denver-market. But the people that we talked to with mandatory renter's insurance programs had no difficulty leasing as a result. From Class A to Class C properties they said the same thing. We were a little skeptical. Once we rolled it out, we experienced the same good results. The program has a dual benefit. It protects the resident's belongings, and it protects us from a liability standpoint."

Renter Acceptance of the Renter's Insurance Program

"Residents recognize that for only $10 a month they get good security for any loss. The important thing for renters to know is that living in a multifamily unit brings exposure from other residents who can cause damage. It's not just you and the circumstances under your control."

Case Study Conclusions

The experience of the renters and Baron Properties in this terrible fire underscores the importance of renter's insurance.

- Renters without insurance were at the mercy of humanitarian relief and had no third-party resources to replace their lost possessions or find new housing;

- Baron Properties invested significantly in housing more than 50 displaced families at the company's expense;

- The loss of this building was covered by property insurance, except for the portion that was self-insured or under the deductible. Since the fire was caused by a resident, the retained risk liability could have been subrogated to a renter's insurance policy and likely collected; and

- Baron Properties discovered after the fact that requiring renter's insurance did not negatively affect their ability to lease competitively.

Case Study 2: Subrogation and E&S Ring Company: Residents and Owner Protected by Renter's Insurance

The following case study documents how renter's insurance saved E&S Ring and its investor clients hundreds of thousands of dollars after experiencing four major resident-caused fires in two years. Among other things, it documents the value of having a large number of renters covered by renter's insurance and the financial support available to the firm from LeasingDesk because its renters were insured.

John Pringle, CEO of E&S Ring Company (7,300 units based in West Los Angeles) explains his company's decision to implement the LeasingDesk renter's insurance program:

> "I have always felt that property owners were exposing themselves unnecessarily to losses from resident-caused events. The typical resident inadequately plans for their own insurance under the false impression that their belongings are covered by the property owner. When a fire happens, resident victims look to the property owner to cover the damage, even if a neighbor caused the fire."

Pringle and E&S Ring have experienced this benefit first-hand – as recently as February 2006.

> "In the last two years, we've had an anomaly—four major fires after several years with none. Two years ago a resident caused a fire by leaving candles burning. The fire was contained in a bathroom, but it still caused more than $100,000 in property damage. We were able to subrogate our claim back to her renter's insurance provider. Last year, we had another fire that caused $110,000 in damage, and we had some renter's insurance coverage that offset our repair costs under our deductible.
>
> Earlier this week, a resident's space heater started a fire in some magazines. The fire burst through the sliding glass door and jumped up the side of the building. Thirty residents had to vacate their homes, and the smoke damage was huge. Residents who left their doors open returned to units covered with charcoal. 22 or 23 of the 30 renters had renter's insurance, although four had allowed it to lapse—including the person who caused the fire. I expect the others will come to us looking for help.
>
> We have put the affected residents up in a hotel for five nights, and we've found apartments for many in our other properties. But I'm certain there will be a[n uninsured] group that looks to put blame and obligation on us beyond what we've done."

On requiring all residents to have renter's insurance

> "We have had no reduction in traffic or leasing success by mandating renter's insurance. Not one blip. One of our investors was opposed to having renter's insurance. His concern was that we would reduce our market pool in

> a moderate income market. He was one of the last in our program, and he had a fire last year. He was very thankful after the fact."

Conclusion

> "The benefits outweigh the cost and effort. If every apartment owner pushed it, all residents would be better off. Coming out of this we're going to re-educate our renters about liability and the dangers of the way they live. It's a solid risk management approach that benefits residents."

Case Study Summary

E&S Ring's experiences contrast with Baron Properties in several key ways:

- In-force renter's insurance provided a safety net of hundreds of thousands of dollars to the property owner for resident-caused fires;
- E&S Ring's fires were caused by common lifestyle choices, like burning decorative candles and charcoal grills, not by gross negligence.
- E&S Ring's latest fire wasn't spectacular enough to warrant large-scale humanitarian assistance or community mobilization. There isn't always a safety net for renters;
- Despite that, displaced residents with renter's insurance had immediate resources to replace possessions and continue renting from E&S Ring;

After the fact, both executives arrived at the same conclusion: requiring renter's insurance has not harmed either firm's ability to competitively lease apartment homes.

Pringle's experience, while unusual, is obviously something that can happen. Even without a run of fires, Pringle's expectations about residents seeking direct compensation from the property owner are worth underscoring. According to the Satisfacts survey, each year an average of eight residents per property request compensation for uninsured losses.

2005 Satisfacts Renter's Insurance Survey At-A-Glance

The Satisfacts survey data was provided by executives at 47 multifamily firms with a combined portfolio of 888,000 units in 3,532 properties.

The survey results show that requiring renter's insurance provides these companies with substantial financial support and little administrative burden. A majority of those that do not use this risk management tool report that they are considering doing so.

Risk Exposure and Cost of Risk

Median per occurrence deductible	**$25,000**
Property Insurance Rates 2005 v. 2004	+2.95%

Claims Experience

Average number of resident-caused claims per property, 2004	**.47**
Estimate of number of formal resident requests for compensation for damage to residents' property (per property per year)	8.25
Average expense per property for resident-caused claims (under the property deductible)	$1,932
Average expense per property for resident-caused claims where renters are <u>required</u> to carry renter's insurance	$1,364
Average expense per property for resident-caused claims where renters are <u>not required</u> to carry renter's insurance	$2,444

Executive Attitudes and Expectations

Companies that <u>offer</u> renter's insurance at some or all of their properties	**55.3%**
Companies that <u>require</u> residents to carry renter's insurance at some or all of their properties	40.4%
Companies that don't require renter's insurance that are <u>considering</u> requiring it	60.7%
Companies that offer renter's insurance that say the program has had a positive or neutral impact on their bottom line	84.6%
Companies that require renter's insurance that say the requirement is "easy" or has "manageable"	90.9%

Insured Renter Survey Data At-A-Glance

eRenterPlan's 2005 survey of insured residents shows they overwhelmingly endorse renter's insurance from LeasingDesk. They are satisfied and report positive claims experiences. Ironically, they also confirm the conventional wisdom—they would not have purchased the insurance if their apartment firm had not required it.

LeasingDesk conducted an online survey of 1,073 renters with renter's insurance from eRenterPlan, a dba name of LeasingDesk. An edited summary of the results follows.

Residents satisfied or very satisfied with their eRenterPlan renter's insurance policy	**98.0%**
Residents who have filed a renter's insurance claim	1.5%
Residents' reasons for claim:	
Theft	82.3%
Water damage	5.9%
Other	11.8%
Why renters purchased renter's insurance:	
Required by lease	64.4%
For a feeling of security	16.6%
For protection in case of accident	15.0%
To provide for my family in a catastrophe	4.2%
How renters signed up for eRenterPlan	
Through apartment leasing office	47.8%
Online at eRenterPlan.com	42.7%
Residents rating eRenterPlan's customer service as excellent or good	85.0%

Conclusions

- Renter's Insurance is a low-cost, low-hassle way to mitigate significant hidden financial risks for a multifamily property owner. Property owners report that renter's insurance programs do not impact their ability to lease apartments.

- Requiring renter's insurance allows firms to subrogate claims for resident-caused accidents to the renter's insurance company. This subrogation option helps firms manage a self-insurance program by creating a deep pocket behind every resident that has a process for claims and the means to pay them. Property owners should recognize that deductibles and self-insurance are very different, and carry different risks and costs. Self-insurance requires managing your own defense and claims process, a hidden administrative cost we estimate at 20% of the cost of paid claims.

- Joshua Tree Consulting conservatively estimates that requiring renter's insurance can save firms $110,000 per 20 properties annually.

- Renter's insurance helps eliminate nuisance claims against the property owner's insurance. Property executives estimate they experience an average of eight nuisance claims per property each year, each of which potentially requires significant time and energy to dispose of.

- Renter's insurance provides a safety net for residents when affected by disaster, and gives them a way to recover financially from damages caused by theft, water or their neighbor's negligence.

- Absent a requirement in the lease, most residents are not motivated to provide coverage for themselves.

- Residents with renter's insurance from LeasingDesk are extremely satisfied with their policy and with the customer service they've received.

- As an industry, the multifamily sector needs to better understand the high value of resident-caused claims. With broader financial understanding the industry will more widely begin to demand renter's insurance and educate renters about the importance of providing for their own financial protection against the risks of high-density living.

Appendix

About the Loss Estimation Model

The model uses loss magnitude and frequency data from the 2004 NMHC Cost of Risk Survey, the 2005 Satisfacts Survey and internal data from LeasingDesk. It assumes an average property size of 250 units per property. This expected value model uses an estimation of loss frequency and magnitude to provide a consistent but non-actuarial analytical framework. It does not take into account non-random factors that can significantly impact actual loss experience.

Instructions

To use the model, the analyst should:

- Input the number of properties in their portfolio in the yellow cells on lines 1, 3, and 5 (replacing the sample numbers that are there), and also
- Enter the amount of their total portfolio deductible and risk retention in the yellow cell on line 23 (replacing that sample number as well).
- Users with significant self-insurance retained will also want to enter their variable costs of administration on lines 12-16 in the highlighted yellow cells.

The potential value of renter's insurance is simply either their total risk retention or expected total loss – whichever is smaller.

Expected Value-Based Loss Model
For Multifamily Portfolios

	Expected Losses								
		Expected Loss (per Incident)	x	Frequency of Loss (per Property per Year)	x	Number of Properties in Portfolio	=	Total Expected Loss	
1	Claims Under $25,000	$ 1,932		47%		20		$ 18,160.80	
2									
3	Claims Over $25,000	$ 25,000	x	4.41%	x	20	=	$ 22,058.82	
4									
5	Largest Claim Over $25,000	$ 234,000	x	1.47%	x	20		$ 68,823.53	
6									
7	**Subtotal Expected Losses**							**$ 109,043.15**	Sum of lines 1, 3, 5
9									
10	Administrative Cost of Risk Retention								
11									
12	Invalid Claims Management								Please estimate annual costs in each line item
13	Moving costs								
14	Transitional housing								
15	Rent forgiveness								
16	Loss to Lease from transfers within portfolio								
17	Subtotal Administrative Costs of Risk Retention								Sum of lines 12-16
18									
19									
20	Total Expected Losses and Costs for a							$ 109,043.15	Sum of lines 7 & 17
21	Portfolio Not Requiring Renters Insurance								
22									
23	Total Self-Insurance and Applicable Deductibles							$ 125,000.00	Input SIR, and deductibles.
24									
25	Expected liability is the lesser of total expected losses (Line 20) or total self-insurance (Line 23)							$ 109,043.15	

About LeasingDesk

LeasingDesk Insurance Services is an Internet-based provider of risk-management products for both renters and apartment owners. Their offerings include renter's insurance, liability insurance and wrap-liability policies for apartment owners which takes effect when residents cancel their liability insurance.

LeasingDesk serves over 2,800 apartment communities (properties with more than 100 units) in all 50 states and Washington D.C. The company serves different types of rental communities including:

- Conventional rental housing
- Military housing
- Corporate and short-term rental housing
- Student housing

A licensed insurance broker, LeasingDesk's policies are primarily underwritten by American Modern Home Insurance Company of Ohio, which has an A+ (superior) rating with the A.M. Best Company.

LeasingDesk is a service mark of Multifamily Internet Ventures, LLC, a privately held company based in Irvine, California. Founded in 1998 by an apartment industry executive, the company's investors, board members and advisors are primarily multifamily operators and investors.

More information about the company may be found on their web site at www.leasingdesk.com.