



Security deposit insurance may result in unfunded liability for low income tenants by Daniel Pessar

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Are we headed to a world without security deposits? If so, there might be cause for concern.

2020 has been a banner year for the security deposit insurance industry. Earlier this year, the Cincinnati City Council passed an ordinance which requires landlords who own and control more than 25 units to offer alternatives to a typical security deposit requirement. Although New York has not yet created a similar requirement for new tenancy agreements, governor Cuomo's pandemic-related executive order 202.28 on March 7th required that landlords allow certain tenants

to use their security deposits “to pay rent that is in arrears or will become due.” The order allows tenants to replenish the security deposit over time or to “retain insurance that provides relief for the landlord in lieu of the monthly security deposit replenishment.”

Security deposit insurance is a three-way agreement among tenant, landlord, and insurance company. The premiums, as low as \$5-10 per month, serve as a replacement for a security deposit, dramatically reducing the amount of money a tenant needs to move in. As well, landlords can receive speedy reimbursement for unpaid rent, fees, or unit damage from the insurance company without having to pursue the tenant for payment. Finally, agreements may require landlords to limit their claims against a tenant to the insurance coverage amount, capping tenant liability.

But there is a potential consumer protection issue here. Low income tenants may opt-in to the insurance option believing that they will be “covered” in the event of a broken lease, damaged apartment, or unpaid rent. Although landlords may look to the insurance company for payment in those situations, the insurance company pursues the tenant for repayment. A resulting claim may surprise tenants who did not understand what they were signing and a judgement can pursue tenants for a long time. Instead of the tenant having security deposit funds set aside to pay for any claims arising out of the lease, the insurance arrangement may lead to an unfunded liability.

Rhino, a security deposit insurance provider, explains on its website (sayrhino.com) what happens if a claim is filed for an amount above the Rhino coverage: “... you’re only liable up to the amount your Rhino policy defines as your coverage amount. Your property cannot file a claim for more than the amount of your policy. This is part of the reason why having the right coverage amount is important.” While this description was meant to assuage concerns about a tenant’s excess liability, it also highlights the potential unfunded liability for low income tenants up to a coverage amount which could reach many thousands of dollars.

Security deposit insurance is innovative and serves a very useful function. It can unlock sorely needed funds for tenant use, speed up landlord reimbursement for claims, and reduce the regulatory compliance burden associated with holding tenant security deposits. As landlords across the country consider security deposit alternatives (reportedly, Stonehenge, Moinian Group, and Starwood Capital Group experimented early with Rhino), operators with lower income tenants should exercise caution before presenting an option that might be attractive in the short term but create an unexpected financial shock after move out.

And to the extent that policymakers are considering making the insurance option mandatory, they should consider whether doing so will lure tenants into an attractive housing option with a low-cost move-in that ultimately leaves them challenged by a large judgement in small claims court.

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