EXPANDING ECONOMIC OPPORTUNITY THROUGH RENTER EQUITY

For those who can afford it, home ownership is a platform for asset development. But the reality is that millions of working poor Americans have no way to build assets. They are challenged to pay for decent housing with low-wage jobs lacking benefits such as paid leave, health care, or retirement programs. In an emergency, such as an injury, layoff, or unexpected expense, they face the choice of losing their homes or sacrificing other basic necessities such as food or utilities.

One potential solution to this issue is an innovative management model for rental housing in which tenants invest their time and attention in property and community management, with the return of cash payments after five years. The approach, called Renter Equity, provides a structure for resident participation that is: 1) clearly defined and measured, 2) positively related to financial earnings from property management, 3) linked to an economic return for residents, and 4) enforceable through the lease.

The Renter Equity approach has enabled residents in affordable multifamily rental housing in Cincinnati, Ohio to earn $140,000 in emergency savings during the past ten years, averaging $430 per household per year. Implementing Renter Equity more broadly would enable thousands of households to build savings while helping to preserve their housing. How does the system work? What are the caveats versus risks of this approach? What needs to happen in order for Renter Equity to be implemented broadly?

The Renter Equity Model

The basic premise of Renter Equity is that resident participation, with the right method and structure, creates operating efficiencies and cost savings. Tasks performed by residents save money on janitorial expense and preventable repairs and improve the safety and curb appeal of the property. Paying rent on time and attendance at meetings reduces administrative expense. Residents must stay for five years to be eligible for a payment - much longer than the average tenure for renters in general. This stability saves money on vacancies and turnover expense. The funds developed stay in the housing project's account until they are withdrawn by a qualified resident. If a household does not stay for five years, they do not qualify for a payment. The housing project develops a surplus that funds a project reserve for making payments to residents.

An innovative component of the model's practice is that residents earn credits on a monthly basis by fulfilling commitments that are easily measurable – to pay rent on time, perform work assignments, and attend resident meetings. An amortized schedule for earnings is part of a Renter Equity Agreement signed with the lease. The schedule looks like the principal repayment on a loan. However, the credits must be earned monthly and only advance when commitments are fulfilled.

Rent receipts, property inspection reports and sign in sheets from meetings are used to document Renter Equity earnings. An entry is made in modified loan management software indicating whether credits are earned or not. The software produces statements for residents as well as management reports for the organization.

The amortized schedule is empowering because it enables residents to set goals and plan for the future. They control the number of credits they earn by making payments consistently on time, attending the monthly meeting, and completing their routine tasks. The amortized schedule incentivizes residents to stay and reduces turnover, since credits accrue at a faster rate the longer they stay. Since the credits are not a gift, residents have to make choices in order to earn them. If they are sick or have a conflict on the nights of the monthly meetings, they should arrange for someone to do their work or attend the meeting for them. They may decide to pay rent ahead in order to ensure that their payments are always on time. If residents consistently do not fulfill their work assignments, or if they violate house rules or miss rent payments, their lease may not be renewed or they may be evicted.

Housing with this management system should be a choice and is not being proposed as a "one size fits all" model for rental housing. Orientations to Renter Equity ensure that prospective residents are the driving force and are making informed decisions. Facilitated resident meetings after occupancy encourage them to take initiative in planning and problem solving and to accept responsibility for fulfilling their commitments. Residents in Renter Equity feel that the agreements, rules, and procedures protect their interests by giving them a voice in establishing community norms.

Holding regular orientations, facilitating resident meetings, enforcing the rules, and inspecting the property to see that work assignments are completed are responsibilities of the manager. Although these tasks take time, the trade-off is that the manager spends less time than other managers on evicting residents, advertising, processing applications, and managing contracts to refurbish apartments. The shift in focus, along with his or her sincere belief that residents are partners on the management team, reinforces the renters' commitment to stability and participation. This outlook fuels demand for the housing, which feeds back into the goal of maximizing rental income and funding the Renter Equity payments.

The time spent to administer Renter Equity credits is offset by efficiencies in other areas of administration, such as collecting rent. The cost of funding the Renter Equity reserve is about $430 per household per year, based on the history of existing projects over the past 10 years. Although the maximum earnings of one household is higher than this, certain factors reduce the average amount of credits owed. These include the fact that not all residents are going to become vested and that earning every single credit is a difficult goal that requires an extraordinary level of commitment.

Owners may be fearful of depending on project earnings to fund reserves for making future payments. What if residents never move and they all achieve the maximum potential credits? Although this would be a wonderful problem to have and would be known in advance, it could require more funding than has been reserved. What if rents are already too low to fund reserves to replace major systems at the end of their useful life? This risk exists with or without Renter Equity management, but it can affect the owner's confidence in being able to make Renter Equity payments to residents.

Other sources of capitalizing a Renter Equity Fund for payments to residents help mitigate the risks of depending on the project entirely for funding. A foundation might establish a guarantee, or insurance pool, for Renter Equity projects that belong or subscribe. A separate reserve fund might be capitalized by an umbrella organization for Renter Equity projects, and this organization might establish best practices for managers and provide oversight and other services to member projects as well.

Alternatively, grants or donations could be made to the reserve established and managed by the owner of the housing. In Cincinnati, one project used a charitable gift for Renter Equity to establish a reserve to cover projected vacancies. The bank agreed that the funds could be drawn back out annually to be used for Renter Equity provided vacancy losses weren't realized, which has been the case. This arrangement can help the developer get the project funded and demonstrates that Renter Equity adds value and not expense.

In addition to earning Renter Equity credits, residents in the Cincinnati projects have access to a loan program. The loan fund was established by socially conscious investors and provides a source of credit for residents who need access to flexible emergency funds to help them deal with unplanned expenditures. Since their creditworthiness is being demonstrated as they fulfill their commitments in Renter Equity, the program provides small amounts for non-reoccurring needs such as an emergency or some unexpected (but costly) opportunity. An alternative to a loan program would be to make forbearance agreements on rent contingent on having a good track record of earning Renter Equity credits.

The Renter Equity lending program enables the payment of rent (a condition of earning Renter Equity credits each month) in the event of unforeseen circumstances. It has been used by some residents to get a payment ahead in their rent, thus assuring that their payment will not be counted late no matter what day of the month it is made. The lending program offers a lower cost alternative to payday or title loans, or unsecured credit from finance companies. The loan is available six months after occupancy, with amortization term typically 12 months. From months seven to 12, up to one month's rent is available. From months 13 to 60, up to two months' rent is available. And after month 60, residents can borrow up to 80% of the earned Renter Equity balance. An administrative fee is added to the cost of the loan, but there is no annual interest rate or penalty for prepayment. The fee covers the administrative costs of the lending program and funds a loss reserve.

After residents are eligible for a payment from the Renter Equity reserve, they have other choices than loans in emergency situations. Whether the best decision for an individual is to take a payment or a loan may depend on personal circumstances. There is no law on whether Renter Equity is income or not. Because there is no determination, Renter Equity payments have been treated as income and the resident receives a 1099-misc. in January for payments in the prior year. Before taking a payment, the recipient may need to consider the impact of the withdrawal on their eligibility for other assistance programs as well as their liabilities, such as a judgment or garnishment order. Another consideration is the fact that withdrawals lower the number of credits that will be earned in the future, since earnings are based on an amortized schedule.

Even though an individual may borrow rather than taking a payment, Renter Equity credits will automatically be withdrawn to make the payment in the event of loan default. The withdrawal to pay off the debt is treated as income and, in addition, any Renter Equity credits earned during the loan period are forfeited.

Evidence

Renter Equity has been successfully operating since 2002. The system has been implemented in three housing rehabilitation projects located near each other in an historic neighborhood near downtown Cincinnati. The census tract has been named one of the most dangerous in the U.S. The median household income in the tract is about $12,000. The housing is owned by nonprofit community development corporations. Banks; a community loan fund; private loans and grants; as well as city, state, and federal programs provided project financing, including low-income housing and historic tax credits. The lending program is operated by a socially conscious investment fund. Grants from diverse private sources funded the development of the management model. A reserve for Renter Equity was capitalized by grants from private foundations and a bank for two of the housing projects. The Renter Equity reserve in one project is funded entirely out of the operating budget of the housing development.

Staff of the nonprofit community loan fund and a private social service organization organized the resident communities during the planning and construction of the housing. Initially, they mailed postcards to neighborhood residents with a follow-up invitation to an orientation. Once orientations to Renter Equity were established on a regular monthly basis, most residents heard about the program through word of mouth. About one-half of the residents moved from other neighborhoods because of the opportunity for Renter Equity. Many of the residents attended meetings for years while they waited for the housing to be planned, financed, and rehabilitated.

The housing is beautiful, clean, and peaceful after more than ten years. Occupancy has averaged about 96%, over 25% higher than comparable low-income rental housing in the same area. Residents are involved in the community council and other neighborhood institutions, and police praise their participation in efforts to reduce crime in the neighborhood.

The average income of the households in the Cincinnati housing is about $18,000. Collectively, residents have earned over $140,000 in financial credits. These credits have helped them pay rent or utilities, relocate after a job loss, buy or fix a car, pay medical or funeral expenses, help other family members, pay off higher cost debt, pay school tuition, and provide a cushion against similar problems in the future.

The lending program has financed another $140,000, which has helped residents buy washers and dryers and stay in their homes when times were difficult. After the six-month residency requirement on borrowers was established, the default rate has been 6%. This is covered by the loss reserve funded by the administrative fee.

Renter Equity management encourages a sense of ownership, provides emergency savings for residents, preserves the housing, and builds healthier communities. Renter Equity can be implemented by any owner who is committed to keeping the housing permanently affordable and providing opportunities for long-term occupancy and resident participation.

Scale

The ultimate goal of Renter Equity is to give all low-income families the opportunity to participate in the property system and earn a return. The taxpayers, the owner, the neighborhood, and the economic system in general will benefit. The model addresses one of the root causes of poverty and offers the potential to generate its own funding, building the foundation for a whole new economic system.

Implementing the Renter Equity model in even a small percentage of affordable housing projects would have enormous economic impact. Approximately 75,000 new or rehabilitated affordable housing units are funded each year under the federal low-income housing tax credit program. The following table projects this impact of Renter Equity management if it is included in 5% of new projects, affecting 3,750 new households, each year. If each of these households earned $430 in Renter Equity credits annually, they'd build $1,612,000 the first year. If the number of Renter Equity projects continues to grow annually by 3,750, credits earned by households in Renter Equity would be worth $88,600,000 in 10 years.

Projection of Renter Equity

Impact Projection												
	# units	3750										
	Credits/HH/Yr	430										
						Years						
# Projects		1	2	3	4	5	6	7	8	9	10	RE Funds
1		1612500	1612500	1612500	1612500	1612500	1612500	1612500	1612500	1612500	1612500	16125000
2			1612500	1612500	1612500	1612500	1612500	1612500	1612500	1612500	1612500	14512500
3				1612500	1612500	1612500	1612500	1612500	1612500	1612500	1612500	12900000
4					1612500	1612500	1612500	1612500	1612500	1612500	1612500	11287500
5						1612500	1612500	1612500	1612500	1612500	1612500	9675000
6							1612500	1612500	1612500	1612500	1612500	8062500
7								1612500	1612500	1612500	1612500	6450000
8									1612500	1612500	1612500	4837500
9										1612500	1612500	3225000
10											1612500	1612500
												88687500

Most significantly, this wealth would never be realized by people in the lowest income groups if they were renting conventionally. The scale could never be supported by “top down” public or private programs, and is generated almost entirely by a change in operating procedures. In addition, Renter Equity housing units have the potential to improve the quality of the housing, reduce or eliminate units’ depreciation, stabilize neighborhoods, and reduce crime. Thus, benefits are spread to the larger community and city in which the projects are embedded.

Caveats and Risks

Affordable housing is the platform for Renter Equity, but the goals are beyond housing. In order for the economic promise of Renter Equity to be realized, the strategy must be implemented in a significant percentage of affordable housing developments. Renter Equity initiatives need help to overcome “growing pains” and expand beyond individual community-based nonprofit housing projects.

The primary focus of housing agencies, banks, developers, and housing owners is to provide the housing. Their ongoing interest is to ensure that the property is maintained and that legal and financial commitments are met. Most management companies have no experience with resident participation in decision making and some are fearful of it. Even though the costs to fund Renter Equity are built into the project's budget for administration or resident services, owners may be unable to find managers with the financial, organizational, and community-building skills that the model requires. Owners and their agents may not have the capacity to administer credits and issue statements to residents, manage the financial assets and liabilities, or operate a loan program. They may be fearful of committing to resident payments. In addition, the prevailing real estate paradigm is that any savings, even if it is generated by resident behaviors, belong to the owner of a rental development.

These obstacles may be overcome by expanding the collaboration between housing developers, managers, and residents with other stakeholders. A safe, stable living environment is fundamental to community and economic development. Residents are seeking to achieve greater stability, healthier communities, and economic freedom. Potential partners who could support these goals include banks, foundations, urban planners, businesses, churches, and other institutions in the community.

One way private sector organizations can support Renter Equity in housing projects is by making grants to establish an operating reserve or a fund for Renter Equity payments. This removes the risk that developers or finance agencies may see in depending on net income as the only source of funding for the resident payments.

An organization is needed to provide services to Renter Equity developers, to modify legacy systems, and to identify and standardize best practices for managing Renter Equity projects. Beyond the level of a few projects, the credit administration and reporting as well as the funds in Renter Equity reserves should be handled by someone other than the property management company or the owner. Developers also need assistance to incorporate the model into their budgets, market Renter Equity, organize resident communities, and find managers who can effectively implement the model. Managers need a forum that enables them to communicate and learn from each other. Best practices need to be tried and documented so that they can be improved. It is critical to the integrity of the system that mechanisms be established to standardize practices, share knowledge, and enforce standards. Who will do this work?

The loan program offers another opportunity for private sector involvement. Housing owners sometimes provide forbearance on rent in order to help their residents. However, they might prefer to partner with a separate lender because they could actually receive a payment. The underwriting is separate, which eliminates the perception of favoritism that might exist if the housing manager is making loans. Lenders may also be able to provide residents with other products and services to improve their financial health.

Management training and support is also key. The agreements, principles, and procedures are carefully structured and need to be followed. The manager’s financial, community-building, and organizational skills need to be developed and mentored. It is important that housing owners and funding agencies are willing and able to give the manager the freedom to respond to resident input in planning, policy development, and rule enforcement. The manager and the owner must learn to track the contributions residents are making and the ways to effectively involve and support residents in achieving their goals.

Managers may need to unlearn practices that cannot be justified in Renter Equity. For example, rents cannot be established or increased arbitrarily. Although they must be increased to cover rising costs, residents need to see the connection. In addition, the rents must be based on policies that take differences such as size and amenities into consideration, rather than just the number of bedrooms. Finally, residents don't want to see the rent they pay used by the owner or manager for another project. This means that maintenance salaries cannot be allocated on a per-unit basis across multiple projects, which is often done.

The amount of effort by housing agencies, managers, other stakeholders to make these changes needs to be determined through research and evaluation. Experience in Cincinnati indicates that the effort is reasonable, and agencies are motivated to do it. The developments in Cincinnati were managed by two individuals, and the evaluation should demonstrate that other managers and projects in different locations can achieve the same results.

Measurements can be designed and put in place in replication projects for continual refinement and improvement. Data from the records and software system used to track credits can also be used to project reserves that will be needed and create actuarial models. Stakeholders can use data to answer questions about impact, train managers, evaluate the performance of the management, and reserve appropriate levels of funding.

Financial measures, inspections, and resident interviews can be used to compare the performance of Renter Equity projects with other comparable affordable housing developments. At another level, perceptions of Renter Equity projects and residents' contribution to the community can be collected through interviews with other neighborhood residents, local businesses, members of the police force, and the staff of the city and other institutions serving the area.

Conclusion

Renter Equity is an innovative approach to managing affordable rental housing in which requirements for participation from resident households are directly connected with the owner's financial bottom line. Measures of effectiveness in completing work assignments, paying rent on time, and attending meetings are built into the operating system, determining the number of credits residents can earn in a financial reserve that provides payments to households. The evidence from small projects is that higher occupancy and savings in expense provide revenue to make the effort self-supporting. However, the management system requires a manager with both financial and leadership skills and has only been implemented by the persons who formulated the approach. It remains to be demonstrated that managers in different neighborhoods can achieve similar results and that the initiative can be implemented on a large scale.

Pilot projects show that affordable rental housing can be managed in a way that encourages a sense of ownership, provides emergency savings for residents, preserves the housing, and builds healthier communities. The benefits for housing providers, residents, the larger community, and economic development are significant. However, the comprehensive approach does not fit within the targets for foundations and agencies that focus on single goals such as improving property management, saving for emergency, providing resident services, or building community. If Renter Equity is to scale up massively, it is not clear which public and private sector actors need to be involved in making changes and when.

Renter Equity installations must coexist with more traditionally conceived rental housing projects and compete with them for funds, sponsors, and housing agency support. An issue here may be that Renter Equity developments will require legacy agencies, funding sources, banks, planners, etc. to change the protocols and procedures they follow to implement and manage projects and interact with tenants. How must they change? These are “known unknowns” that need to be anticipated and included in policy plans.

Next steps are to create an operating manual for managers, implement the model in several demonstration projects, and evaluate results. Concurrently, a team of people knowledgeable about the various interests and incentives of stakeholders should be assembled to design a systems dynamics model. The model need not be mathematical but can be used to describe relationships and resources and help answer questions about the impact of possible policy initiatives to expand Renter Equity and associated costs and benefits.

Once these questions are addressed, Renter Equity could bring low-income people who are left out of ownership into the economic system and help resolve many social problems. There is always a limit on funding for programs that help the poor by depending on donations or public investment. This is self-limiting and does not get at the root of the economic problem. The need for more affordable housing and the income and wealth divide continue to grow. There are costs to create infrastructure to establish and manage relationships between housing providers, managers, and the new financial system to which it is linked. However, the approach has the potential to be self-sustaining once established. The residents of the housing will benefit from the opportunity to contribute to their community, build savings, and experience new economic opportunities indefinitely.

Questions and Answers About Renter Equity

1. **How is this model different from Mutual Housing? Is the main difference the explicit economic return residents in this model can receive?**

   Renter Equity is a model for management that systematically defines resident participation and increases its effectiveness. The Mutual Housing Association is a model for ownership that keeps the housing permanently affordable and provides opportunities for long-term occupancy and resident participation. Renter Equity should work well for Mutual Housing Associations, but any owner that shares the goals of the new model can implement Renter Equity.

2. **The tragedy of the commons suggests some tenants might have incentives to freeload. What happens if no one cooperates?**

   The tragedy of the commons is the depletion of a shared resource by individuals, acting independently and rationally according to each one's self-interest, despite their understanding that depleting the common resource is contrary to the group's long-term best interests. Renter Equity sets up incentives so that no rational actor has an incentive to deplete resources. All incentives in fact at individual level are to maintain and improve common resources. Non-rational actors are not recruited and evicted. Thus the tragedy of the commons does not appear to be applicable.

3. **Is there an incentive to inflate rents to fund reserves just to maintain equity payments?**

No. Most residents of affordable housing do not receive a rental subsidy and are struggling to pay rent out of pocket. They could be forced to move if rents are inflated. In addition, housing development and subsidy programs establish maximum limits on rents and rates of increase. There are also limits on the maximum income of households. Inflating rents would be counterproductive if the manager can't replace lower-income residents with ones who can pay more.

4. **What are some of the regulatory and legal issues for resident accounts? How will this approach work for someone with a judgment or a garnishment order?**

The funds for payments are held in a financial account controlled by the owner. Residents' credit accounts are tracked separately, and they have no income until they receive a payment. Someone with a judgment garnishment order should consider the impact before taking a payment. The loan may be a better alternative.

5. **Will clients in ChexSystems be able to open an account? How will account rules apply to these reserves and payments to residents? Do state credit agencies support this model?**

It seems there is an opportunity to link Renter Equity to credit reporting and enable residents to improve their credit score based on their success in meeting rent payments consistently on time. However, property managers cannot afford the time and cost of reporting to credit agencies. Once the system has been replicated and is managed at a larger scale, this could be an opportunity for another financial innovation.

6. **How are bad debts pursued?**

The loan fund and the Renter Equity fund are separate. If loans are not repaid, legal action can be taken in small claims court.

7. **How will multifamily underwriters treat the model for loans or equity investments?**

The assumptions normally used for developing and underwriting multifamily rental housing still apply. In the event that residents don't participate in Renter Equity, rental housing will still be managed traditionally. The project's future performance should be evaluated based on the performance standards used for rental housing, not the higher ones needed for Renter Equity.

Developers may also be uncertain about how the funders will view them. Since Renter Equity does not change the proforma budgets, the developer can determine how much to highlight the management system in their applications. Funders do require a management plan and approve the manager's capacity and credentials. But the nonprofit owner can state that it plans to use net income to further its mission, which includes Renter Equity, without going into a detailed description.

Alternatively, highlighting Renter Equity may improve the project's chance of being approved for funding. Orientations document demand more reliably than a market survey. Since the resident community is organized during planning and construction, the lease up period is much shorter than a typical rental project. Public agencies are looking for ways to improve management practices and preserve the life of affordable housing. Some organizations have a mission that goes beyond providing housing. Banks may like Renter Equity because it reaches people that their other financial products and programs can't.

8. **Are these LIHTC projects by definition?**

   No, but 90% of affordable developments include some financing from low income housing tax credits (LIHTC). The model must work in these projects in order to be scalable.