

Fiscal Cliff Endangers Tenant Leases

Will there be an uptick in tenant lease defaults? This blog explores the issue.

Over the past four years, commercial property owners have had periods when they felt like they were on a free-falling down-elevator, watching as the sub-basement of their investments got ever closer. Then came eight quarters of good news: The Multifamily Vacancy Index, which peaked at 70% vacancies in second-quarter 2009, was at 36% in second-quarter 2012, about the same as 2011's average.

But don't pull out the sleigh bells and start riding high with Santa just yet. It seems the up-escalator is bound for the wrong kind of height—one Federal Reserve Chairman Ben Bernanke referred to in February 2012 as the “fiscal cliff.”

One of the programs in danger of collapse as of January 2013 is unemployment benefits. The assistance plan is one of many slated for major cutbacks, meaning the ongoing—almost chronic—extensions of benefits to workers unemployed for up to 99 months would end. Such a reduction in aid to the more than 2 million unemployed who receive jobless benefits could result in an uptick in tenant rent default.

Lease defaults can include cessation of rent payments, evictions for non-payment, abandonment of a unit, and a break in payments based on a court-recognized hardship, among others. In all cases, multifamily dwelling owners may be hit with months of rent loss along with vacancies or, in some cases, in-place non-paying residents. Defaults can also lead to legal costs to have the tenant evicted.

Solutions for Multifamily Housing Owners

While you may have little control over the unemployment situation or Congress's moves to avert the fiscal cliff, you do have control over the losses you experience from tenant lease defaults. Stop-loss programs are available for very large commercial residential owners and investors, and tenant non-payment insurance is available for standard landlords.

Tenant lease default insurance covers certain legal fees as well as months of lost rent, based on the reason for default, rental fee and duration of loss. Policies are often provided on a stand-alone basis, so you don't need to purchase rent default coverage as part of your master policy or other commercial insurance. By purchasing a tenant lease default policy, you may also increase your building's worth and your own creditworthiness. Generally speaking, the lower your financial risk from tenant default is, the more attractive you are to prospective lenders and investors, should you at some point want refinancing, private equity financing or a sale.

While the application process for rental payment income protection is fairly easy, you should know a few things. Most insurers want proof that you are taking appropriate steps to verify the creditworthiness and low risk of your tenants. That often includes a background check that would reveal bankruptcy claims or previous lease defaults or evictions. It might also include some credit score rating for both you and your tenants. Many insurers will want to review your

occupation lease contracts, and there could be other requirements for eligibility. You should also know that many insurers require a waiting period before the policy activates. Since that is typically 60 days or more, you should act now. Don't let your business dangle from the fiscal cliff longer than it has to.

What do you think? Please share your thoughts!

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