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Single-Family Rental Industry: Companies Lean on Tenant Chargebacks To Effectively Cut Operating Expenses

Industry Update

Cleaning up sewage in a tenant's basement could be costly for American Homes 4 Rent, a public company that leases single-family houses in mostly suburban neighborhoods. But a profitable solution exists - bill the tenants.

The cost of repairs and services that by contract, or even by law, are the landlord's responsibility are increasingly getting pushed on tenants by American Homes and some of its peers in the developing institutional single-family rental (SFR) home-rental business.

Consumer complaints brought to court, to state attorneys general and posted online cite chargebacks that include bills for repairing plumbing and gas leaks and replacing worn out appliances. Tenants also claim the companies are tacking on unjustified fees and surcharges when they process credit card payments and when they bring utility billing in-house with the help of Conservice, a vendor that processes utility bills. Improper charges when tenants leave a property is also a concern.

The cost shifting is effectively reducing operating expenses and bolstering the bottom line of American Homes and Invitation Homes, the largest institutional SFR companies, according to financial statements filed with regulators. American Homes' tenant chargebacks as a percentage of property operating expenses was 25 percent in 2016, more than tripling over the past three years.

Invitation Homes and the company it recently merged with, Waypoint Homes, do not report tenant chargebacks separately; instead they report chargebacks in a category called "other property income." Even so, the companies show reliance, on "other property income" in order to effectively cut company expenses.

Tenant complaints about these chargebacks point to systematic and aggressive strategies. Many current and former tenants say they have pointed out damage prior to renting properties but were told the dwellings were rented in "as is" condition or promised that the problems would be addressed in the future.

Later, either during occupancy or after move-out, the tenants say they received chargebacks for repairs of the same problems they had identified earlier. The companies have then sought to force payment by applying monthly rent to the charge, threatening eviction, retaining security deposits, sending unpaid bills to debt collectors and damaging the tenants' credit rating, according to the complaints.

But tenants are increasingly resisting charges that they view as unfair, unfounded or simply the responsibility of the landlord, posing a possible threat to the companies' profit margins.

The aftermath of a basement sewage flood in a two-story rental home near Atlanta encapsulates the situation. Two months after American Homes hired a vendor to clean up the mess and repair the septic system, the tenant learned the company had applied half of her rent payment to the remediation and was now threatening to evict her for allegedly failing to pay rent due.

The tenant, Leighanne Johnson, said she only saw a bill for the cleanup after asking for it repeatedly and that the landlord is yet explain why she has any liability at all for the damage. Landlords in most states are required by law to provide tenants with a functioning septic or plumbing system.

"After I started asking questions and disputing the charges, the property manager wanted to negotiate, offering to split the bill," Johnson said in an interview with *The Capitol Forum*. "I didn't want to start down that road because I didn't see an end in sight to them taking my rent and applying it towards more of the landlords' repair bills."

Johnson said she has been locked out of the online payment portal, a common tenant complaint, so she hand delivers the monthly rent and utility payment while she disputes the chargeback and eviction threats.

American Homes did not respond to an inquiry about Johnson's chargeback or what options exist for tenants who wish to dispute chargebacks without risking eviction. Six days after we emailed American Homes questions about Johnson's chargeback and looming eviction, American Homes emailed the tenant to inform her that the entire chargeback and late fee were reversed. The email did not provide any information as to why the chargeback had been applied or why it was now being reversed.

Industry already under cloud of SEC scrutiny. The fledgling SFR industry has already caught the eye of the SEC in an unrelated matter. Investigators are scrutinizing American Homes, Tricon Capital Group, and Invitation Homes and the company it since merged with, Starwood Waypoint Homes, over its methods for valuing homes used as collateral in rental-income securities.

On January 22, American Homes disclosed it was the subject of a second SEC probe, this one related to Silver Bay Realty Trust Corp., a SFR company traded publicly until February 2017 when it was acquired by Tricon Capital Group. The SEC demanded documents related to American Homes' purchases, sales and holdings of Silver Bay stock as well as communications with Silver Bay's financial advisor.

In-Depth Look at Tenant Chargebacks

Tenants' rental account histories posted online or attached to complaints filed with regulators show charges for maintenance, ongoing repair, and, as we reported previously, turnover costs. American Homes responded by email to a query asking for the company's definition of tenant chargebacks with a statement of what charges the company puts back onto its tenants.

According to American Homes, chargebacks are "primarily comprised of resident reimbursements for utility expenses while they occupy our homes, and reimbursements for damages assessed at move out (security deposit forfeits)."

Invitation Homes uses the term "other property income" to refer to a bundle of items that includes tenant chargebacks, according to financial reports filed with the SEC. The reports show "other property income" consists of the following: utilities, HOA fines, and other chargebacks, pet rent and nonrefundable deposits, and various fees such as nonrefundable application fees to view dwellings and lease termination fees. Starwood Waypoint Homes, recently consolidated with Invitation Homes, also bundled tenant chargebacks in the "other property income" revenue line item, which included smart home service fees, late charges and early termination charges as well as tenant chargebacks, all of which were billed to tenants.

Invitation Homes did not respond by publication to questions asking for the company's definition of tenant chargebacks and if all tenant charge-backs are included in the "other property income" line item on its financial reports.

Tricon Capital Group, parent of Tricon American Homes, does not specifically disclose revenue from tenant chargebacks in the company's financial reports, which don't mention the term. Tricon Capital Group did not respond to emailed questions about the company's tenant chargeback policies or reporting methodology.

SFR landlords are becoming increasingly reliant on shifting landlord expenses onto tenants. As tenant chargebacks play a greater role in effectively cutting operating expenses, some SFRs have become increasingly heavy-handed in demanding tenants pay up, according to interviews with more than 30 current and former tenants and reviews of tenant complaints posted online and submitted to regulatory agencies.

Techniques include applying rent payments to repair bills; blocking tenants from making future rent payments unless repair charges are paid; threatening eviction; placing menacing debt collection phone calls, retaining security deposits; and ruining tenants' credit rating by sending accounts to debt collectors.

The companies at the same time are also larding up on auxiliary fees to boost earnings, tenants complain. One Arizona tenant wrote on a Facebook page that their SFR landlord, which, at the time was Colony American, inexplicably tried to impose onto the tenant a fine from the HOA for delinquent dues.

"Then suddenly I have a $1,395 HOA fine," the tenant wrote. "Hired a lawyer. Went to court. I won." Soon thereafter, the tenant moved out of the home after renting it for eight years from a series of companies that by now has eventually merged into Invitation Homes.

Another tenant, Adrian Mason, sued American Homes in small claims court in Florida for inflating utility bills among other charges. Mason alleged that he obtained copies of utility bills for his rented home directly from the service provider and discovered American Homes charged $1,487 on a $1,116 bill.

"That was an overcharge of $371 and we are requesting that AH4R refund that in addition to the other charges," Mason said in the complaint. The case settled, according to court records. Mason did not respond to a request for comment.

In some states, attorneys general will forward consumer complaints to the business accused of wrongdoing and set a deadline for a response. Many tenants have received undisclosed settlements or reversal of charges in response to the officials' contacts.

Expenses cut. SFR companies' financial reports show the institutional SFR companies effectively cutting expenses by increasingly pushing costs onto tenants and adding income with additional charges such as late fees, application fees, utility processing fees, non-refundable pet deposits, pet rent, HOA fines, and lease termination fees. A direct comparison cannot be made among the companies.

American Homes reports tenant chargebacks as a separate line item. Invitation and Waypoint don't isolate tenant chargebacks in a single line item in financial reports, rather the companies choose to bundle fees, charges and chargebacks in single line item named "other property income." Tricon doesn't disclose tenant chargebacks at all.

American Homes' "tenant chargebacks" as a percentage of "property operating expenses" has grown annually from 2 percent in 2013, 8 percent in 2014, 19 percent in 2015, to 25 percent in 2016.

Waypoint's "other property income" as a percentage of property operating and maintenance" was 31 percent in 2016 up from 28 percent in 2014. Looking forward, Waypoint's "Other Property Income" figures will be combined with those of Invitation in future financial reports due to the recent merger of the two companies. Invitation Homes' "other property income" as a percentage of "property operating and maintenance" expense was 12 percent in 2016, up from 9 percent in 2014.

Tenants charged for wear and tear. As previously reported, chargebacks are common when tenants move out and are billed for move-out costs. Speaking anonymously due to concerns over her ongoing dispute with the company, the Arizona tenant who successfully resolved the $1,395 HOA fine said she recently discovered a $8,000 debt on her credit report stemming from her stint in the home.

The chargebacks were mostly for ordinary wear and tear after an eight-year tenancy and charges for upgrades to the home. She provided a copy of the description of the charges to *The Capitol Forum* which showed roughly $4,500 dollars for replacing the carpet and repainting, a $550 dumpster, plus charges for re-glazing windows, re-caulking the bathrooms, replacing light switches, toilet seats, shower heads and ceiling fans.

The Arizona tenant hit a dead end when Waypoint told her the debt is too old to dispute with them and she needs to work it out with the debt collector who simply reconfirmed the validity of the debt, she told *The Capitol Forum* by email. "Nobody would rent to me, so I had to find a co-signer to help me buy a house because they ruined my credit from that $8,000 charge."

"Security deposits deductions, or chargebacks, are an old issue in the apartment business," said David Barker, Professor of Finance at University of Iowa and partner at Barker Apartments in emailed comments. "I think that some of the new rental house companies are struggling with them for a few reasons; they are not always run by people with experience in multi-family housing, it is harder to monitor a scattered portfolio of houses than apartments in a complex, and house tenants stay longer and feel more like owners and they cause more wear and tear."

"The standards for wear and tear are kind of arbitrary but length of occupancy is a factor," Barker said. "For example, assume that the carpet lasts for seven years with ordinary wear and tear, so we would not charge a tenant for carpet damage if they (or previous tenants) had lived on the carpet for seven years, regardless of what they have done such as cigarette burns, bleach stains, or pet damage," Barker said by email.

Barker said that tenants do have some remedies, "other than small claims court, tenants can file class action lawsuits. Some states allow double or triple damages if a deposit is unreasonably withheld."

Reputational damage, tenant disputes and to the extent any regulatory agency may scrutinize these practices may begin to erode the companies' ability to impose chargebacks. Thomas Herndon, Professor of Economics at Loyola Marymount University, said, "Anything that affects their cash flow would negatively affect the financial health of the companies."