

MANDATORY SECURITY DEPOSIT INSURANCE

Summary

A bill would likely require housing providers (with 5 or more units) to offer a security deposit insurance product in addition to a traditional security deposit. A bill would likely also cap the total allowable security deposit at one month's rent.

Elements and Consequences

Security Deposit Advantages

- Many wrongly assume security deposits are much larger than they are (one month's rent is a widely held belief). The actual industry average is less than 1/3 of month's rent. A security deposit is not a material barrier to renting a unit.
- Residential leases are the most unbalanced consumer transaction available in our economy. The average transaction involves one person exchanging a ¼ million-dollar property to the other, based on a written promise to pay about ½ a percent in of the value of that property monthly, without any collateral. Compare that to typical terms of a car loan or mortgage requiring (20% down) or a shirt or hamburger (100% in advance).
- Security deposits assist people with bad credit and bad rental history in obtaining housing. Many people who would be too risky to lend ¼ million-dollar residence to can be safely taken on as a customer using a reasonable security deposit.
- Security deposits allow very poor people to gain the advantages of leverage and the ability to borrow items of immense value, usually available only to those with high levels of income and proven credit history.
- Security deposits allow unrelated people to mitigate the risk of liability from nonrelated roommates.
- Any artificial cap on the amount of the security deposit limits the ability to safely rent a residence to the poor. The more restrictive the cap, the more people deprived of housing.

Problems with Security Deposit Insurance

- These products are unreasonably expensive. The upfront cost is typically about 1/3 the cost of the required security deposit. When a monthly payment option is offered, the monthly payments over the life of the lease exceed 1/3 the deposit.
- The reason these products are not widely used is precisely because residents and housing providers recognize that the products are poor values compared with the alternative of a security deposit.
- Coverages under these products vary widely, with many items typically covered by this security deposit not being covered by the insurance product. Housing providers and residents lose money when the insurer denies a claim.
- If the lease is renewed, these expensive premiums are due again.
- Many of the products are not insurance at all, but rather surety bonds, where the product provider is left with the ability to collect any proceeds paid on behalf of the resident from the resident. The resident pays the premium for the "insurance" and then still owes the money for the covered claim.

Problems with Mandating Security Deposit Insurance

- The bill requires housing providers to offer a product that's such a poor value, it doesn't sell itself.
- Because of the wide variety of coverages, premiums and exceptions, these are extremely complicated products to accurately and fully explained to the consumer. There will be a substantial level of misinformation and misunderstanding between housing providers and residents over the terms and limitations of these products.
- Residential leases come in all shapes and sizes and one size fits all mandated transaction terms will never work for the entire spectrum of transactions.
- These products often require that the entire community be forced to purchase the product, making them not voluntary for residents at all.
- The demand for these products does not justify the administrative expense of participating in these programs.