



## Regarding Security Deposit Replacement Products

As state legislative sessions get underway in many states this month, advocates can anticipate bills in many states seeking to legitimize various versions of financial products, from companies such as Rhino or Lease Lock, designed to take the place of security deposits for rental housing. Though these products (which I will call Security Deposit Replacements or SDRs) vary in finer details, the basic scheme is as follows:

- Instead of posting a security deposit, a tenant pays a nonrefundable monthly fee to an SDR company for “coverage” up to an amount equivalent to what the security deposit would have been;
- If the landlord has a claim against the tenant, such as for property damage beyond wear & tear, the landlord presents the claim to the SDR company;
- The SDR company pays the landlord’s claim (up to the coverage maximum), thereby acquiring a claim for subrogation against the tenant.

SDR lobbyists present these products as a “win/win” for tenants and landlords, as they enable tenants to move into rental properties without the high up-front cost of a security deposits while still providing landlords with the same level of financial security. The industry bills seek primarily to achieve a carve-out for their products (which may not comply with general insurance regulations or security deposit laws),<sup>1</sup> though some go further and actually obligate (some) landlords to inform tenants of the SDR products<sup>2</sup> or refrain from treating tenants less favorably because they opt for SDR.<sup>3</sup>

### Potential benefits of Security Deposit Replacement products

SDR products are not a win/win. But they can offer some benefits to tenants. For one, the ability to pay a monthly fee in lieu of a large, lump-sum security deposit may indeed be important to some renters—even though tenants who can afford lump-sum deposits will usually be better off tendering a refundable deposit than paying a nonrefundable monthly fee. And although renters’ insurance will generally cover liability for negligently-caused property damage, common renters insurance deductibles are \$500 or

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<sup>1</sup> See, e.g., Oregon House Bill 3306 (2021), <https://olis.oregonlegislature.gov/liz/2021R1/Measures/Overview/HB3306>

<sup>2</sup> See Cincinnati Ordinance No. 10-2020 (Jan. 15, 2020), [https://city-egov2.cincinnati-oh.gov/Webtop/ws/council/public/child/Blob/55479.pdf?rpp=-10&w=doc\\_no%3D%27202000057%27&m=2](https://city-egov2.cincinnati-oh.gov/Webtop/ws/council/public/child/Blob/55479.pdf?rpp=-10&w=doc_no%3D%27202000057%27&m=2)

<sup>3</sup> See Texas Senate Bill 1783 of 2021 (passed May 30, 2021, effective Sept. 1, 2021), codified as <https://legiscan.com/TX/text/SB1783/2021>, codified as Texas Prop. Code § 92.111, <https://statutes.capitol.texas.gov/Docs/PR/htm/PR.92.htm>; see also Washington Engrossed Substitute House Bill 1515 of 2021, <https://legiscan.com/WA/text/HB1515/2021>

\$1,000<sup>4</sup> – so a genuine insurance product that actually covers and pays smaller landlord damage claims could also be of value to some tenants. But in evaluating these potential benefits to renters, advocates must consider several considerations: whether the SDR products actually deliver the promised benefits, whether the costs are reasonable, and whether the manner in which SDR products are marketed results in them being regularly sold only to renters who benefit from them.

### **Avoidance of substantial move-in costs**

Substantially all of the SDR products enable tenants to avoid paying up-front security deposits. But whether this will remain true long-term, or whether landlords might begin imposing security deposit requirements in addition to SDR products (as is already common with renters' insurance), is unclear. Consider the following remark from LeaseLock lobbyist Jon Potter:

“Tenants do not purchase LeaseLock products. LeaseLock insures landlords against unit damages and/or lost rent. With that coverage, landlords are comfortable offering tenants the option to waive the security deposit requirement if tenants pay a deposit waiver fee. LeaseLock is not a party to the deposit waiver fee transaction.”<sup>5</sup>

Since tenants do not purchase the SDR products directly, and since the SDR companies do not require landlords to waive security deposit requirements, nothing (other than theoretical market forces) would appear to prevent a landlord from requiring a security deposit in addition to an SDR product (or, perhaps better stated, an SDR product in addition to a security deposit). The SDR product also imposes no limit on the amount of the “deposit waiver fee” that may be charged—so even if landlords do not begin imposing traditional security deposits on top of SDR policy requirements, landlords could begin extracting additional profits from the SDR fees (i.e., charging monthly fees greater than the cost of the SDR policies, or possibly imposing up-front fees as a condition of using SDR products).

A second risk question mark respect to whether SDR products actually enable tenants to lease housing without large up-front fees is the possibility that landlords might treat applicants who utilize SDR products less favorably than applicants who tender traditional security deposits. Some of the existing and proposed SDR legislation prohibits such discrimination.<sup>6</sup> Absent such legislation, tenants could face such discrimination without legal protection. Of course, depending on the quality and practicality of legal remedies, tenants may commonly experience such discrimination even where statutory protections exist.

Accordingly, the best way to ensure that tenants seeking to avoid large up-front security deposits actually receive that intended benefit of SDR products would be to support legislation that (i) prohibits landlords from charging security deposits in addition to SDR policies, (ii) prohibits deposit waiver fees in excess of the monthly premium on the SDR product, and (iii) prohibits less-favorable treatment of tenants who opt for SDR products.

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<sup>4</sup> See, e.g., Mark Fitzpatrick, “Choosing a Renters Insurance Deductible,” ValuePenguin.com (Sept. 22, 2021), <https://www.valuepenguin.com/renters-insurance-deductible>

<sup>5</sup> Email from Jon Potter to Eric Dunn (Oct. 15, 2021) (on file with National Housing Law Project).

<sup>6</sup> See, e.g., Texas Prop. Code § 92.111(a)(2) (landlord “may not use a prospective tenant's choice to pay a fee in lieu of a security deposit or a security deposit as a criterion in the determination of whether to approve an application for occupancy.”).

## Security Deposit Replacement products as insurance coverage

The other supposed benefit of SDR products is as a form of insurance for smaller landlord damage claims (either in lieu of renters' insurance or as additional coverage for items costing less than the deductible amounts). Yet some of the SDR products simply do not amount to any such insurance coverage. For example, consider the following account regarding the Rhino product:

The bond's coverage amount was set at \$7,200. When Steininger signed the contract, he didn't realize he was agreeing to repay Rhino for any claims paid to his landlord up to that amount—more than twice the original deposit, and more than twice his monthly rent. He paid a \$45 fee each month for the service.

Shortly after he moved out, Steininger learned his landlord had made two claims against the policy. The first was for \$3,500, or a full month's rent. An email from the property management company explains that the roommates surrendered the apartment Sept. 2 when they were supposed to move out Aug. 31. Steininger says they did move out Aug. 31 but were two days late returning the keys.

The second claim was for \$2,500 for alleged damages. Steininger disputes these charges, particularly the \$1,400 charge to remove trash, cut a bicycle lock, and remove a bike from a fence outside the apartment. 'The thing is, I have that bike,' he says. 'They said they cut the bike lock. I have the lock intact.'

Rhino pays out claims within an average of four business days. Steininger's landlord was able to collect \$6,000 from the company, and the company is now pursuing Steininger for reimbursement.<sup>7</sup>

Whereas Rhino appears aggressive about pursuing tenants for amounts paid to satisfy landlord damage claims, apparently not all do so. Indeed, LeaseLock claims it "has never sought reimbursement from a tenant and has no plans to seek reimbursement from tenants."<sup>8</sup> This could, of course, change if the SDR companies hold subrogation claims they simply choose not to pursue.

When SDR companies do pursue tenants for subrogation claims, they may potentially avoid a number of procedural limitations and defenses that often apply to landlord damage claims or security deposit withholding under state law. For instance, state landlord-tenant laws frequently require walk-through inspections and checklists and the outset and completion of a tenancy, impose notice or documentation requirements for asserting charges, and time limits for the return of deposits. Failure to comply with such procedures may compromise a landlord's ability to withhold security deposit funds or even waive a landlord's claim altogether. Some states even authorize statutory damages or attorney fees for wrongful withholding. Defenses and tenant protections of this nature can not only enable some tenants to defeat landlord damage claims, but also supply significant negotiation leverage for tenants and may deter some landlords from pursuing such charges. But where no security deposit is tendered and the

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<sup>7</sup> Alex Williamson, "Security Deposit Alternatives: The Misleading Marketing of 'Renter's Choice,'" Shelterforce (Dec. 10, 2020), <https://shelterforce.org/2020/12/10/security-deposit-alternatives-the-misleading-marketing-of-renters-choice/>

<sup>8</sup> Email from Jon Potter to Eric Dunn (Oct. 15, 2021) (on file with National Housing Law Project).

SDR company seeks only to collect subrogation for monies it paid to satisfy a landlord's claim for amounts owed by the tenant, some of all of these defenses may be unavailable.

Accordingly, the best way to ensure that SDR products provide an actual insurance benefit for property damage claims would be through legislation defining authorized SDR products only as those that either treat the tenant as the insured party, treat the landlord as the insured party but prohibit subrogation claims against the tenant, or at least limit subrogation to particular circumstances (such as where the damage is intentionally caused). There should be no room in the marketplace for predatory products such as Rhino, which benefit only landlords while imposing all costs upon tenants.

If states insist on passing SDR legislation but will not prohibit or at least restrict subrogation to egregious circumstances, they should at minimum ensure tenants facing subrogation claims have equivalent procedural protections (such as inspection checklists and timely notice of claims) as exist under security deposit statutes so they can rely on the same substantive protections and defenses against the SDR company as would have been available against a landlord seeking to withhold funds from a security deposit or collect a tenant damage claim directly.

### **Costs of Security Deposit Replacement products**

The cost of an SDR product should of course be reasonable—meaning reasonable both in relation to the actual benefits received as well as in comparison with a traditional security deposit.

The actual costs of SDR products is not entirely clear. LeaseLock reports that “the average deposit waiver fee is \$22. The average rent of insured units is about \$1400.”<sup>9</sup> Rhino appears to charge about \$5 per month for every \$900 worth of security deposit (hence a \$1,400/mo. rental with a one-month security deposit requirement would cost around \$8/mo.)—though quotes also appear to differ geographically.<sup>10</sup> Over 12-month lease term in a \$1,400/mo. apartment, then, a LeaseLock security deposit waiver fee would cost a tenant about \$262, and a Rhino waiver would cost about \$96.

While these charges are obviously much lower than a \$1,400 security deposit, the SDR product fees are nonrefundable. With an SDR product that does not actually insure the tenant, such as the Rhino product, the monthly deposit waiver fee might best be viewed as an interest-only payment on a loan (having a principal in an amount equal to the security deposit). An \$8/mo. payment in lieu of a \$1,400 security deposit reflects an effective annual interest rate of 6.35%, which is not facially unreasonable for a tenant who seeks to avoid paying a lump-sum deposit. Though some tenants might have lower-cost credit available to them, that rate is certainly superior to what consumers might expect from a credit card or paycheck lender. Such cost is not reasonable to a tenant who could have made a full lump-sum deposit and avoided any such charges altogether, however—further reinforcing the importance of ensuring that SDR products remain optional and do not become obligatory.

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<sup>9</sup> Email from Jon Potter to Eric Dunn (Oct. 15, 2021) (on file with National Housing Law Project).

<sup>10</sup> See sayrhino.com, <https://www.sayrhino.com/> (last visited Jan. 4, 2022); see also Alex Williamson, “Security Deposit Alternatives: The Misleading Marketing of ‘Renter’s Choice,’” Shelterforce (Dec. 10, 2020) (“[Rhino’s] website estimates that a user could satisfy a \$3,000 deposit for \$24 per month in Philadelphia, \$18 per month in Los Angeles, or \$17 per month in Atlanta, for example.”), <https://shelterforce.org/2020/12/10/security-deposit-alternatives-the-misleading-marketing-of-renters-choice/>

The price of an actual insurance product, such as LeaseLock purports to be,<sup>11</sup> is better compared not to interest rates but to renters' insurance premiums. According to NerdWallet.com, "the average renters insurance cost in the U.S. is \$168 per year, or about \$14 per month ... based on a policy for a hypothetical 30-year-old tenant with \$30,000 in personal property coverage, \$100,000 in liability coverage and a \$500 deductible."<sup>12</sup> The (curiously similarly-named) site MoneyGeek.com estimates "[t]he average cost of renters insurance this year is about \$13 per month, or \$159 per year, for \$20,000 of personal property coverage, \$100,000 of liability coverage and a \$500 deductible."<sup>13</sup> Insurance.com reports much higher costs: "average cost for the policy with \$100,000 in liability coverage is about \$27 a month or \$326 a year" even with a \$1,000 deductible.<sup>14</sup> Insurance.com also notes wide geographical variation in the costs of renters insurance: "Mississippi, Louisiana and Oklahoma are the most expensive, at between \$540 and \$580 a year. Vermont and Wyoming are the cheapest, at about \$160 a year."<sup>15</sup>

LeaseLock, costing around \$262 per year for a \$1,400 policy, is well within the window of rates framed by these competing estimates. But while the premium is similar, the policy covers only personal liability (it does not insure a tenant's own belongings), and only up to the amount of the usual security deposit (typically one or two months' worth of rent, compared with \$100,000 liability coverage). This is offset by the effective absence of a deductible and, as discussed above, relief from the usual obligation to post a lump-sum security deposit. Whether these benefits are worth the cost will presumably differ from one tenant to the next—but this exchange would not appear manifestly unreasonable.

Even though these costs do not appear unreasonable at present, ensuring tenants have the ability to shop for and choose the best SD replacement product available could be important to ensuring the costs (and value for the money) remain reasonable over time. Allowing landlords to choose the product invites moral hazard and incentivizes SD replacement companies to make their products appealing to landlords rather than tenants.

### **Consumer confusion and abusive marketing of Security Deposit Replacement products**

Finally, SD replacement products should be sold only to renters who want them and actually benefit from the products. States should not enable landlords to make SDR products obligatory for all tenants, and should ensure that SDR vendors do not engage in deceptive or confusing marketing practices that lead renters to purchase SDR products they do not need or that do not do what renters expect.

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<sup>11</sup> Note that LeaseLock functionally insures tenants by declining to seek subrogation from them, even despite having a possible legal right to do so. Were LeaseLock to decide at any time to begin pursuing subrogation, or assigning its claims to third-parties who would do so, the product would cease to function as insurance for tenants.

<sup>12</sup> Sarah Schlichter, "6 Reasons Not to Skip Renters Insurance," NerdWallet.com (Apr. 21, 2021), [https://www.nerdwallet.com/article/insurance/do-you-need-renters-insurance?trk\\_channel=web&trk\\_copy=6%20Reasons%20Not%20to%20Skip%20Renters%20Insurance&trk\\_element=hyperlink&trk\\_elementPosition=0&trk\\_location=PostList&trk\\_subLocation=image-list](https://www.nerdwallet.com/article/insurance/do-you-need-renters-insurance?trk_channel=web&trk_copy=6%20Reasons%20Not%20to%20Skip%20Renters%20Insurance&trk_element=hyperlink&trk_elementPosition=0&trk_location=PostList&trk_subLocation=image-list)

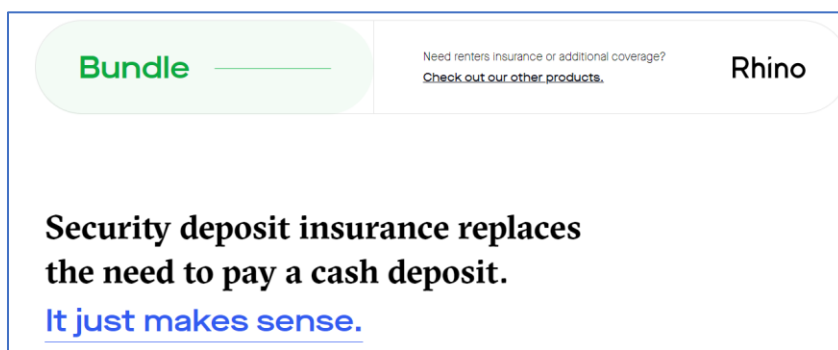
<sup>13</sup> Margaret Wack, "How Much Does Renters Insurance Cost? The Average Cost of Renters Insurance Per Month," MoneyGeek.com (Dec. 27, 2021), <https://www.moneygeek.com/insurance/renters/average-cost-of-renters-insurance/>

<sup>14</sup> Michelle Megna, "How much is renters insurance?" Insurance.com (Jul. 16, 2021), <https://www.insurance.com/average-renters-insurance-rates>

<sup>15</sup> *Id.*

Probably the most common opportunity for consumer confusion or exploitation with respect to SDR products is to sell such a policy to a tenant who has the means of posting a refundable security deposit and would be happy to do so. Such a tenant is always better off posting the lump sum and paying no deposit waiver fee. Obligating such a tenant to purchase an SDR product anyway, or causing that tenant to purchase an SDR product through deception, pressure, or taking advantage of confusion, would be exploitative and abusive. Such a tenant should always have the choice of posting the traditional security deposit and avoiding the nonrefundable fees, and the availability and superiority of this choice should be made fully apparent to all such tenants.

The other main avenue through which consumer confusion and exploitation is likely to arise in connection with SDR products is a misunderstanding of how the products function as “insurance.” Rhino, for instance, markets directly to consumers and holds its product out as “security deposit insurance.”<sup>16</sup>



Describing the Rhino product to renters as “security deposit insurance” is confusing because it tends to suggest that renters who purchase the product will have liability coverage for property damage they may cause—yet they do not.

By comparison, LeaseLock describes itself as “a B2B company that sells insurance to owners of rental housing” and which “does not communicate or contract with tenants.”<sup>17</sup> In marketing only to landlords, LeaseLock avoids this risk of confusion.

Though Rhino’s marketing is confusing and arguably misleading, by marketing directly to consumers Rhino at least gives renters the ability to pursue that product if they find Rhino’s price and product features superior to other options. But renters who find a better deal than LeaseLock may not be able to effectively utilize other products with landlords who contract with LeaseLock—a product “fully embedded” into the management company’s computer systems:

“LeaseLock is fully automated, and integrates with all major leasing systems including Yardi, Realpage, Entrata, Resman and MRI. Throughout the full lease cycle, the platform is embedded in online lease checkout, lease execution, monthly billing and accounting, receivables and automated claims, and property performance metrics.”<sup>18</sup>

<sup>16</sup> Screenshot from sayrhino.com, <https://www.sayrhino.com/>, Jan. 4, 2022.

<sup>17</sup> Email from Jon Potter to Eric Dunn (Oct. 15, 2021) (on file with National Housing Law Project).

<sup>18</sup> LeaseLock.com, Frequently Asked Questions, <https://leaseLock.com/faqs/>, last visited Jan. 4, 2022

Not only does the integration of LeaseLock software with other property management functions likely inhibit consumer choice and market competition, but LeaseLock’s long-term plan appears to be the complete replacement of security deposits with monthly deposit waiver fees on “every lease”—not only for those tenants who struggle with up-front move-in costs:<sup>19</sup>



As discussed above, a product such as LeaseLock may be worthwhile to a tenant who wants to avoid paying a lump-sum security deposit and who find the non-refundable monthly fee acceptable in return for the insurance coverage provided. But for many tenants, paying a refundable security deposit is more economical and the insurance LeaseLock provides is not worth the price (either because the tenant perceives a low risk of needing the coverage, or because a low-deductible renters insurance policy is available at similar or lower cost).

Ensuring consumer choice in SDR products thus appears even more critical, to ensure that large property management firms do not contract in droves with LeaseLock and require tenants to purchase the product as a condition of renting there irrespective of the tenant’s individual situation.

### **Legislative considerations**

As discussed above, security deposit replacement products are not all the same, and are not uniformly good or bad for tenants. At the same time, traditional security deposits are not necessarily a fantastic deal for tenants either—and may or may not carry strong consumer protections depending on the particulars of state law. The challenge for advocates confronting legislation to green-light SDR products in their states is therefore a complex one. Before supporting such legislation, advocates must consider how SDR products would be treated under the pre-existing security deposit/move-in fees laws of their states.

In many jurisdictions, an SDR policy would be simply incompatible with permissible move-in charges or security deposit rules. In that scenario, advocates should carefully consider whether SDR products produce an overall net benefit to tenants compared with the drawbacks discussed above, before supporting legislation that would authorize the sale of a product that otherwise would not be permissible.

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<sup>19</sup> LeaseLock.com, <https://leaseLock.com/zero-deposit/>, last visited Jan. 4, 2022

In other jurisdictions, existing law does not stand in the way of SDR products—and new legislation could provide an opportunity for advocates to secure meaningful consumer protections around their use. In still other situations, some version of SDR legislation may be destined to pass, and the best advocates can hope for is to make such legislation as fair and protective of tenants as possible, given the political realities in place. In circumstances such as these, where SDR product legislation appears either helpful or inevitable, advocates should pursue the following principles:

- ***Tenants should always retain the option of posting a traditional security deposit.***
  - At the outset of the tenancy
  - Option to post a security deposit later and terminate SDR fees
  - Landlord may not treat tenant less favorably based on choice
- ***Tenants should post a traditional security deposit OR pay for an SDR product***
  - Tenants should not have to pay for both
  - Tenant should owe only monthly premium for SDR product, no other amounts
- ***Choice of SDR product belongs to the tenant***
  - Landlord may specify the amount of coverage needed but may be require a specific vendor or product
  - Landlord may not treat tenant less favorably based on choice of product or vendor
- ***SDR products must provide actual insurance***
  - SDR vendors shall not have subrogation rights against tenants in insured units
  - Possible exceptions for malicious or intentional damage
  - If SDR products are not going provide actual insurance, then (i) a raft of advertising restrictions and consumer disclosures needed to minimize the risk of tenants thinking they are buying coverage when they are not, (ii) tenants need to be assured that any claims the SDR company (or assignee) attempts to assert against the tenant are subject to any defenses, counterclaims, etc., that the tenant would have had against the LL, and (iii) the bill should impose an express duty of care on investigating any claim the landlord make before paying it, with notice to tenants of the claim and access to all evidence and documentation; (iv) the state should commit enforcement resources
- ***SDR products must be fully and clearly explained, with consumer protections supplied***
  - Express prohibition any false or misleading statements or statements unreasonably likely to cause confusion on the part of a tenant;
  - Full and clear, large-print disclosures of all material terms (e.g., cost of the product per month, per year, throughout the lease term, etc., comparison of total tenant will pay vs. a security deposit, the fact that the payments are not refundable whereas a security deposit is refundable);
  - Clear, large-print statement that at any time the tenant may cancel the product and submit a security deposit to the LL instead;
  - If subrogation not prohibited, then clear, large-print disclosure that the product is not insurance and that the tenant remains liable for any property damage beyond wear & tear or other legitimate charges owed to LL, and that any amounts the product pays the LL will not reduce that liability;



- Prohibition of mandatory arbitration of any claim affecting the tenant
- Prohibition of any class action waivers or other anti-consumer provisions
- **Enforcement**
  - Stand-alone cause of action for actual damages, statutory damages, and attorney fees (or make violations per se actionable under a consumer protection act containing such remedies);
  - If subrogation not prohibited, then any representation by the vendor to a renter that the SDR product is "insurance" results in the product actually constituting insurance for that tenant (i.e., any claims paid in connection with that tenant for damages shall not be recoverable against the tenant through subrogation).