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Tips When Using Surety Bonds in Lieu of Traditional Security Deposits

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The use of surety bonds in lieu of traditional security deposits is becoming commonplace within California's multifamily market, with owners and managers of some 30,000 units statewide now offering them as a resident amenity and/or a risk management tool.

Owners statewide have offered surety bonds for more than ten years to help reduce move-in costs for potential residents. The current state of our economy has made this an attractive option for many residents because the cash savings that result from the lower cost surety bonds leave extra spending money for other moving expenses. In California, where traditional security deposits can equal one month's rent or more, many owners are accepting surety bonds to help them compete for residents by making their community more affordable.

Surety bonds can be accepted by owners in place of a traditional security deposit as a means to protect themselves (owners) against unrecoverable losses due to damages to an apartment caused by the resident that go beyond normal wear and tear or skipped rent. At a time of intense focus on balance sheets, security deposit alternatives have become part of a risk management strategy for owners statewide.

You should consider the qualifications of both the insurance company and the agent. Surety bonds are governed by the California Insurance Code. An insurance contract is a product of a licensed insurance company, but those products are typically sold through unaffiliated general agents. Thus, both the strength of the insurance company and the experience and practices of the agent are important considerations.

In evaluating an insurance company, the company must be licensed, and its financial strength can be checked through third-party rating agencies such as A.M. Best.

An owner's contact with the insurer flows through the agent, who is contracted by the insurance company to sell and administer its products. It is important to use an agent with a proven track record and experience and knowledge about the specialized California rental market. The agent's role is to provide information and proper documentation which onsite leasing staff can offer prospective residents who are considering enrolling in a surety bond program. The agent also serves as the contact for owners with questions about the program and filing claims. The resident completes the agent's enrollment forms and pays the surety bond premium directly to the surety through the agent, not the owner, as with a traditional security deposit. Much like home or auto insurance, the surety bond coverage amounts vary with the risk management needs and size of the community, as well as with the risk profile of the prospective resident (e.g., credit history). It is recommended that owners not require or accept surety bonds for more than the maximum security deposit allowed under California law.

Owners must also understand the claims filing process to receive payment from the surety. Upon a resident's move-out, if there is rent owed or physical damage, the owner or property manager submits claim documentation to the agent. The documentation is very similar to the security deposit accounting and supporting documents that the owner or property manager is already required to provide to a resident that has paid a traditional security deposit. The owner also provides the security deposit accounting and supporting documents to the resident as required by California law.

After the claim is paid, the agent – not the owner – seeks reimbursement from the renter who remains responsible for complying with his lease terms under the surety bond agreement. [The owner would seek reimbursement from the renter only if the amount due from the resident exceeds the surety bond amount. The amount sought by the owner directly from the resident would be only the excess amount.]

A reputable surety requires the owner to follow the procedural and substantive requirements of California's security deposit laws.

Understanding how surety bonds are regulated and offered in California as a security deposit alternative is key to making an intelligent and informed decision about whether or not they are a good option for your community. Your leasing attorney and apartment association representatives are good sources for additional information about surety bonds in California, and they should be consulted before you make a decision about whether surety bonds are right for you.

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