

INVESTMENTS:

Tenant Quality: When You Hire Your Tenants, Hire Well

When I sell a car, I want to give it to the person who shows up first with the money I am asking for it. Too many of us real estate investors are renting our properties this way. Our investments are amongst our most important assets, and we need to protect them by *choosing* good tenants.

Years ago, I attended a real estate conference where tenant selection was discussed. The speaker made a case that choosing tenants for your property is exactly like hiring employees for your business. If

your new employee empties the cash register one night, just like he did at his last two jobs, then that is YOUR fault as an employer for not finding that fact in a background check.

Similarly, the type of tenant who moves in and never pays a dime in rent while gaming the eviction process for a free place to stay has usually done something like that before. That type of tenant would give you a list of his friends as "landlord references," but he can't fake background or credit checks.

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This month, we'll discuss the hiring process for your tenants, and illustrate some ways you can minimize your risk by doing some homework.

Who is the Lease Guarantor?

Every single lease has a *guarantor* – this is the person or entity who is guaranteeing payment under the lease. If Joe and Mary Tenant are renting an apartment from you, then Joe, Mary or both would be the guarantors. If Joe and Mary are just out of college, you may want Joe's dad Fred to be the guarantor – as a *co-signer*. If Joe owns a sandwich shop, then he may be the guarantor on the lease – no matter what happens with the shop, he needs to pay the rent. If the sandwich shop is a large enough company, (Firehouse Subs, for example), then perhaps the lease can have a corporate guaranty – where a parent company guarantees the lease. (It's important to verify this if it's assumed, as I'll discuss later.)

How Strong is that Guaranty?

Those of us in the investment business hesitate to use the "G word" of guarantee often because the very sound of it implies that something is as sure as the sun coming up tomorrow, or the IRS collecting taxes next year. A guarantee, in reality, is only as strong as the person making it. If Joe and Mary are just out of college with little savings, then Fred may be a good bet as a co-signer: but only if he has sufficient financial means with which to make rent payments, if necessary. If Joe's Sandwich Shop fails, how likely is it that Joe the guarantor will make good on his rent payments if the sandwich business is his only means of financial support? (Not very.) If Firehouse Subs corporate is the guarantor of our lease, then they have to make the lease payments as long as they as a corporation are in business. Are they doing well and likely to stay in business? We'll need to look at their financial information to find out. Lastly, note that the "large chains" like Kentucky Fried Chicken and Subway are most likely run by *franchisees* and not by corporate. This means that it's

not KFC corporate, (YUM Brands), that is guaranteeing your lease – it's the franchisee – who could be the Joe mentioned above. The same argument against his sandwich shop applies here – if the KFC is doing poorly, and it provides a substantial amount of Joe's income, how is he going to pay the rent?

My Tenant Hiring Process

My investments that I manage myself are exclusively residential rentals. When I am looking for a new tenant, I'll collect information from multiple potential tenants and "hire" the best one. I will ask for, and review, personal information, employment history, a paycheck stub copy, a bank account statement copy and copies of identification cards. I will also perform a credit check and a criminal background check. I will always personally call to verify employment and past rental history. I don't accept co-signers so if none of the potential tenants are up to snuff, I'll wait until I have more tenants to review. I still fill my vacancies quickly and have been, so far, very happy with the tenants I've hired. I think this extra effort is certainly worth my time, and it probably will be for you too. If you have any questions, please call me at (877) 313-1868.

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