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Key Contact:

David Cardwell
VP of Capital Markets and Technology
dcardwell@nmhc.org

Other NMHC/NAA Staff Contacts:

Douglas M. Bibby
President
dbibby@nmhc.org

James N. Arbury
Senior VP of Government Affairs
jarbury@nmhc.org

Lisa Blackwell
VP of State & Local Strategic Outreach
lblackwell@nmhc.org

Kimberly D. Duty
VP of Communications
kduty@nmhc.org

Jeanne Delgado
VP of Property Management
jdelgado@nmhc.org

Eileen C. Lee
VP of Environment
elee@nmhc.org

Howard Menell
Tax Advisor
hmenell@nmhc.org

Ronald G. Nickson
VP of Building Codes
rnickson@nmhc.org

Mark Obrinsky
VP of Research and Chief Economist
mobrinsky@nmhc.org

Automated Electronic Payments: Leveraging Technology for Cost Effective Collections and Transaction Management

By Bill Barkwell, Ryan Gilbert, and Ken Miller

- This NMHC White Paper provides an overview of automated payment services and technologies and illustrates suitable implementation options in the multifamily sector.
- It discusses the benefits of convergent billing and payment models and integrated data-centric implementation approaches.
- It offers an overview of transaction pricing models for each option, and discusses key compliance considerations and underwriting considerations for the establishment of merchant accounts.
- A checklist of key considerations for a successful implementation is also included.
- Recommended Distribution:
 - Chief Executive Officers
 - Executive Managers
 - Information and Technology
 - Finance and Treasury
 - Revenue Enhancement
 - Property Operations
 - Marketing Executives

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ABOUT THE NATIONAL MULTI HOUSING COUNCIL

Based in Washington, DC, **NMHC** represents the interests of the nation's largest and most prominent firms in the apartment industry. NMHC members are engaged in all aspects of developing and operating apartments, including ownership, construction, management, and financing. The Council was established in 1978 as a national association to advocate for rental housing and to provide a source of vital information for the leadership of the multifamily industry. Since then, NMHC has evolved into the industry's leading national voice. The association concentrates on public policies that are of strategic importance to participants in multifamily housing, including finance, tax, property management, environmental and building codes. NMHC benefits from a focused agenda and a membership that includes the principal officers of the most distinguished real estate organizations in the United States. For more information on joining NMHC, contact the Council at 202/974-2300 or www.nmhc.org.

ABOUT THE AUTHORS

William F. Barkwell is President of Ambling Management Company, and is responsible for all facets of the company's operations, including strategic planning, new business development and operations. A pioneer in the use of technology to improve operational efficiencies in all aspects of real estate finance, operations and administration, Barkwell's career includes the development and implementation of automated accounting systems enabling organizations to remain on the cutting edge of technology. Additionally, Barkwell was one of the first property management executives in the nation to fully automate all financial and tracking aspects of property management. Prior to being appointed President of Ambling Management Company, Barkwell was chief financial officer of Ambling Companies, Inc. Barkwell also served as chief operating officer and client reporting officer for Pinnacle Realty Management Company in Seattle, Washington as well as vice president and residential controller for Insignia Management Group in Greenville, South Carolina. Barkwell also served with Duddlesten Management Corporation of Houston, Texas, as senior vice president and chief financial officer at the time the company was purchased by Insignia. Barkwell holds a Bachelor of Business Administration degree from the University of Houston in Texas.

Ryan Gilbert is CEO and Co-Founder of PropertyBridge, a provider of managed payment services to the multifamily industry. Gilbert applies technology, financial services, legal and real estate experience to his role at PropertyBridge. His professional activities have centered on creating revenue-driven business models for strategic opportunities, capital raising, corporate restructuring and alliance development for companies including Accenture, American Express, CMGI, Castelle, HP/Compaq, Key3Media, Wells Fargo Bank and Wine.com. Gilbert is an active member of the State Bar of California, and is also admitted to practice law in the United Kingdom and South Africa. Gilbert earned his Bachelor of Commerce and Bachelor of Laws from the University of the Witwatersrand, Johannesburg.

Ken Miller is CIO of Ellipse Communications, Inc. and leads the company's Large Business Accounts division which provides complete customized web development to property management companies and institutional investment corporations. Miller applies over 22 years of technology-related experience to his activities in the multifamily industry. Prior to joining Ellipse, Miller has been engaged in several entrepreneurial initiatives as a private consultant, serving such companies as Post Apartment Homes, Inc. and InterMark Management Corporation. For three years, Miller served as CIO for Ambling Companies, Inc., an industry provider of student and affordable housing. He has also assisted fee-managed-based Pinnacle Realty Management Company with its strategic technology initiatives. Miller previously held several technology management positions with Insignia Financial Group, Inc., including vice president of information technology for the company's residential and commercial divisions. Miller graduated cum laude from the University of South Carolina at Spartanburg, earning a Bachelor of Business Administration degree with a concentration in data processing.

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Please understand that the information discussed in this guidance is general in nature and is not intended to be legal advice. It is intended to assist owners and managers in understanding this issue area, but it may not apply to the specific fact circumstances or business situations of all owners and managers. For specific legal advice, consult your attorney.

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INTRODUCTION

Automated electronic payments have undergone significant development and enhancement with the rise of the Internet and e-commerce and the development of technologies, data exchange standards, and regulations.

In 1995, leading national banks processed the first electronic transaction via transmission control protocol/Internet protocol (TCP/IP), enabling merchants anywhere to transact business with customers online. This marked the launch of e-commerce as we know it today.

In the National Multi-Housing Council 2004 Property Management Software User Satisfaction Scorecard, property owners and managers ranked electronic payment solutions as the number one capability they wanted to add in upcoming software upgrades, citing a range of competitive and business process benefits.

This owner and manager feedback is consistent with the responses of major U.S. corporations to consumer behavior. According to comScore Networks (June 2005), during 2005, approximately 34 million U.S. consumers regularly paid their bills online, an increase of 12 million over 2004. Furthermore, 84 percent of consumers reported preferring online payment options that are included on the site of the merchant they are paying. The study cited two reasons for high adoption:

- the fact that payers can wait to make a payment until the due date without incurring late fees; and
- the increased penetration of broadband Internet connectivity.

Reports such as these correlate with data showing that the echo boomers (ages 20–29 years), the largest group of renters, have been early adopters of Internet technologies. These findings are motivating property managers to implement online payment solutions. Jupiter Research's *Online Bill Viewing and Payment Forecast (2004 to 2009)* (January 2005) projects that by 2009, more than 90 percent of U.S. households will manage daily payment transactions online.

In addition, VISA and MasterCard are expected to change their interchange pricing model for certain transaction types, including rent-related payments, to spur volume growth. In April 2005, VISA offered a flat-rate-per-transaction model for utility bill payments; MasterCard also offers an incentive rate for this category.

For property managers and owners, the benefits of automated payments include the efficient and accurate management of transactions and funds and the ability to improve bad debt management, reduce float times, and automate transaction reconciliation and reporting.

Additional benefits of a properly implemented automated payments solution include the following:

- *Integration*
Standards-based data exchange options allow for improved integration between established automated payment solutions and property management and accounting systems. Streamlined (and often automated) posting of transaction and deposit data to financial management systems saves time and eliminates the duplicate data capture processes common in many management offices today.
- *Accelerated Payment Collections and Funds Availability*
Real-time authorization and settlement of payment card transactions and Check 21 image processing of paper-based payments, coupled with “next day” funding of settled transactions, allows for accelerated availability of funds and an improved float.
- *Enhanced Security*
Security standards enforced by financial industry leaders and advanced transaction processing and security protocols protect against fraud and data theft online and on-site.

- *Multiple Payment Options*
Automated payments include more than credit card payments. Check readers convert paper checks and money orders into electronic items for processing; on-site personnel can accept payments through virtual terminals that connect to payment card and automated clearinghouse (ACH) payment tools; check or card payments mailed to central lockboxes are scanned for electronic deposit and settlement; payments via bank bill payment sites can be sent to communities' direct deposit accounts for next-day settlement; even person-to-person payment services such as PayPal may be offered as payment options.
- *Reduced Delinquencies*
An improvement in bad debt collection as a result of payment choice is a benefit for both residents and managers. Payment card acceptance stands out among automated payment options as an effective tool for reducing delinquencies and avoiding late fees.
- *Resident Amenity*
Residents welcome the ability to choose single or recurring payments from their checking accounts or credit cards.
- *24-Hour Availability*
With automated payments, the "office" is always open. Both residents and managers benefit from the convenience of real-time authorization and settlement of card transactions and "late" deposit options for ACH and Check 21 transactions (typically up to 5 p.m. Pacific Time).
- *Improved Reconciliation and Business Processes*
A centralized reporting system for cash management makes reconciling bank deposits easier. Refunds and partial payments may also be made through the same channels and user interfaces.

Implementing automated electronic payments is not without its costs. In addition, privacy and data protection requirements, integration with existing business systems, training and support of personnel, and compliance with a broad range of federal, state, and industry regulations must be considered. However, the range of affordable and scalable payment and implementation options available offsets these costs and will fit the needs of most businesses.

This White Paper covers key considerations associated with the selection, implementation, and management of an automated electronic payment system for an apartment company. It will serve as guide for internal due diligence and decision making. The authors invite correspondence on any topics and questions arising from this document.

DEFINING PAYMENT ALTERNATIVES

Automated electronic payment options comprise more than just the online acceptance of credit card payments. They encompass a broad range of payment types that may be deployed in a number of channels and integrated with property management software systems.

When defining a payments strategy, a good initial goal is to offer multiple payment types in multiple payment channels. Payment channels are the modes or places where the payment is accepted; payment types are the means of payment, such as credit cards or paper checks.

Payment channels include the following:

- In person: Physical or virtual terminals accessible only by authorized personnel who accept payments in the leasing office
- Online: Typically through customized Web-based payment pages accessed via a link from the property manager's or community's Web site

- By phone: Interactive voice response payments interface, accessible through a toll-free telephone service, with live operators for advanced support
- By mail: Centralized lockbox services designed to receive and process payments on behalf of third parties

Different payment alternatives are suitable for different environments. When determining the best payment mix for an apartment complex, it is essential to consider the residents. What are their demographics? Which payment type seems most closely aligned with their banking behavior? What are they asking for?

It may be both feasible and advisable to offer all payments types and allow consumer choice to prevail. Suitable deployment options for each payment type and channel may include:

Payment Option	In Person	Online	By Phone	By Mail
Payment Cards	X	X	X	
ACH	X	X	X	
Check Electronification	X			X
Lockbox				X
Person-to-Person payment Service		X		
Bank Bill Payment		X		

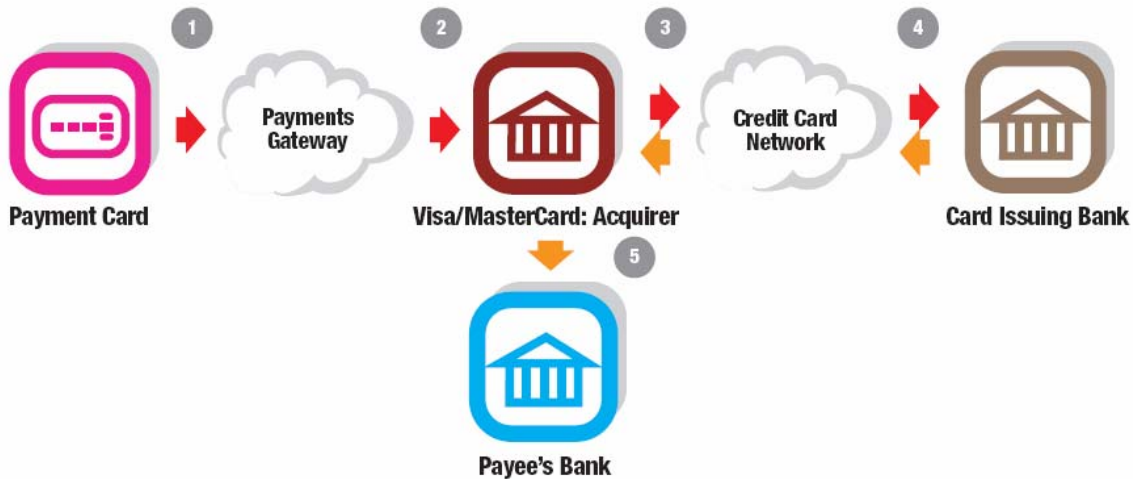
Options: Multiple Payment Types in Multiple Payment Channels

PAYMENT CARDS

Third-party processors and banks offer a range of options to accept all credit and debit card types.

When a transaction is initiated, the processor transmits a file via the acquiring bank to the card-issuing bank requesting authorization of the charge. The card-issuing bank accepts or rejects the transaction within seconds; if it accepts the transaction, it issues a settlement request, resulting in funds being reflected in the merchant account. Funds, less any returns and card processing charges, are sent to the manager’s direct deposit account on the next business day in accordance with the community’s disbursement instructions.

Payment Card Transaction Process



Chargebacks—transactions that are disputed by a cardholder and are refunded—are sent to a merchant as soon as the credit card processor receives them from the card-issuing bank. Chargebacks are debited from the owner’s operating account. Payment processors offer chargeback management services to challenge the chargeback and substantiate the transaction and minimize potential losses. The historic industry average for chargebacks in the property management sector is less than 0.5 percent, and processors’ chargeback management tools coupled with accurate record keeping will enable managers to minimize chargeback losses.

The bank card associations and processors have implemented fraud management and chargeback guidelines to curb transaction risks. Fraud can be prevented by implementing Address Verification Service (AVS) matches to verify that billing information a resident uses on the Internet matches the credit card issuer’s record and the resident’s card verification value (CVV) (the unique three-digit value encoded on the credit card’s signature panel).

Transaction fees are based on “interchange”—the fee that a bank card association levies to draft funds from the cardholder’s issuing bank to the merchant’s acquiring bank, and to transmit accurate billing information to the issuing bank. Interchange fees may vary in accordance with association regulations and the capture of card data, address, and electronic transaction confirmation.

The actual rate the apartment owner or manager pays may be a pass-through of the gross cost of processing for each element of the transaction or a blended rate that includes fees to the bank card association, the acquiring bank, and the third-party credit card processor.

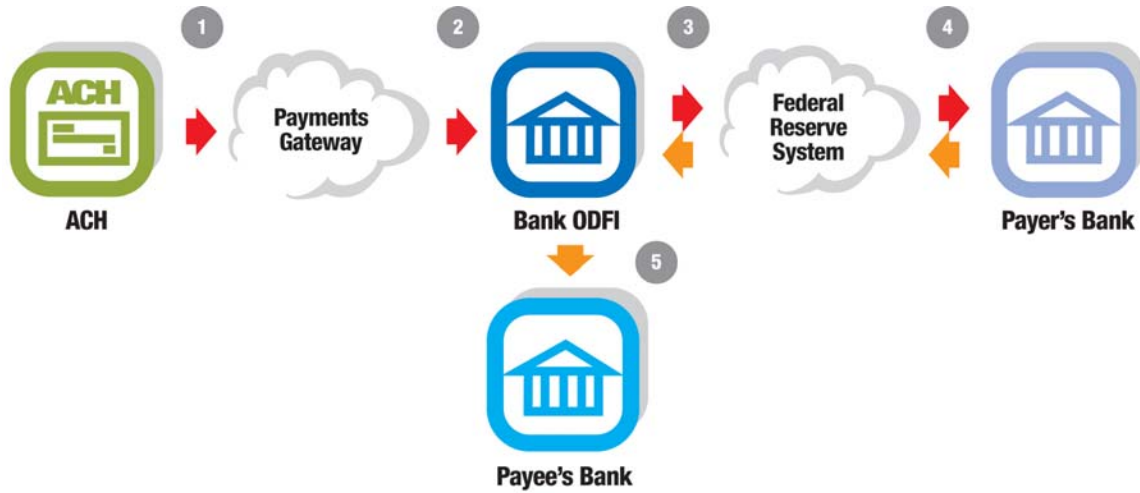
An owner or manager may recover the costs of each transaction by assessing a convenience fee for payment card transactions. Each manager determines this fee. It must be a flat fee and cannot be based on a percentage of the transaction. The fee must be fair, and must be charged for all payment types in the same payment channel. The fee may not be charged in the primary payment channel (for example, swiping a credit card through a card reader in the leasing office). American Express does not permit convenience fees.

ACH

The ACH Network is a nationwide batch-oriented electronic funds transfer system, comprised of interlinked regional automated clearinghouses. It is governed by the National Automated Clearing House Association (NACHA) Operating Rules, which provide for the interbank clearing of electronic payments for participating financial institutions. The Federal Reserve and electronic payments networks act as ACH Operators—central clearing facilities through which financial institutions transmit ACH entries.

ACH transactions may be created by scanning paper checks or through single or recurring payments authorized by the account holders. ACH files are submitted through processors to the ACH clearing bank, also referred to as an originating depository financial institution (ODFI). The ODFI acts as a central bank for ACH transactions.

ACH Transaction Process



The ODFI then transmits the file containing ACH debits to each payer's bank, also referred to as the receiving depository financial institution (RDFI). Since the Federal Reserve System is a "trusted network," the RDFI is obligated to honor all ACH transactions, and 100 percent of the funds are credited to the owner's clearing account.

Depending on the banking relationship, funds may be available on a next-day, two-day, or 72-hour basis. It takes up to two business days for all transactions to process through the ACH Network and to know if the item was good or bad. Items can be returned for insufficient funds (NSF) or as an administrative, stop payment or unauthorized payment return.

The RDFI has up to 48 hours from the effective date of the transaction to determine whether the resident's bank account has sufficient funds to cover the ACH debit or whether to return the transaction for another reason, such as closed account, wrong account, or frozen account. If the debit needs to be returned, the RDFI sends a return notification back to the ODFI, and the ODFI passes the return through the processor, which immediately debits the owner's clearing account for the amount of the return.

ACH returns may be received over the next 60 days and are debited to the owner's operating account as they are received. These types of returns, which comply with the ACH rules, typically relate to disputed transactions in which a payer may contend that the transaction was never approved. By retaining authorizations, whether paper-based or electronic, a manager may be able to reverse the return.

ACH transactions include the following modes:

- Accounts Receivable Collection: Conversion of a check received via the U.S. mail or a dropbox location
- Point of Purchase: A single debit pursuant to a source document (check handed over) that is returned to the payer
- Prearranged Payment and Deposit: A single or recurring debit based on a signed authorization form
- Internet: A single or recurring debit based on an authorization received and recorded via the internet

- Telephone: A single or recurring debit based on an authorization received and recorded via telephone

ACH fees include per-item fees, monthly account fees, reporting fees, and NSF and return fees. Fees are typically debited monthly from the owner's operating account and credited to the processor.

CHECK ELECTRONIFICATION

The conversion of a resident's check into ACH transactions using check scanners has long been an option for apartment managers. However, the benefits of check electronification have been limited because ACH could not accept common payment items such as money orders, cashier checks, and corporate checks. A visit to a bank to deposit the items was still necessary.

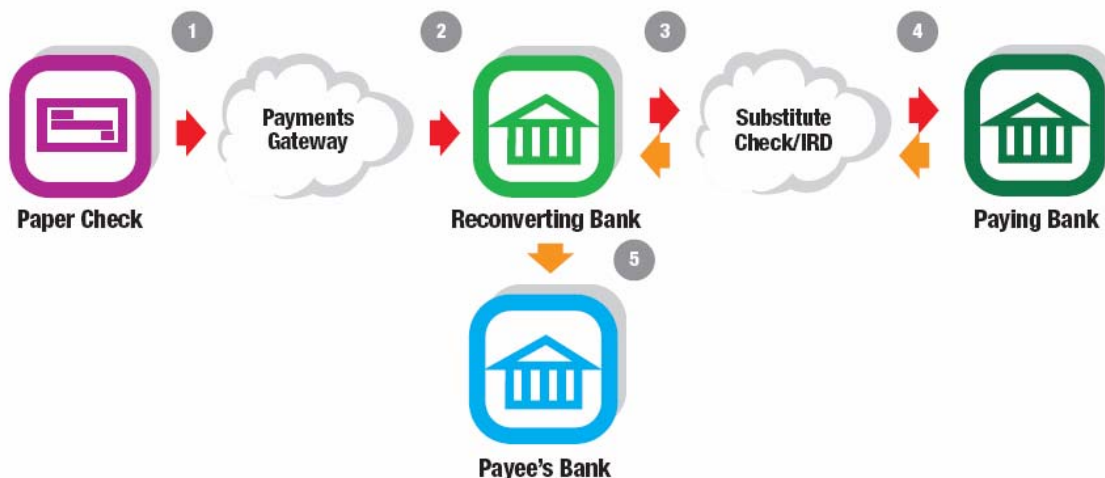
A new era in check electronification dawned when the Check Clearing for the 21st Century Act (Check 21) became effective on October 28, 2004. Check 21 was designed to foster innovation and enhance efficiency by reducing some of the legal impediments to check truncation.

The law facilitates check truncation by creating a new negotiable instrument called a substitute check (also referred to as an Image Replacement Document or IRD), which permits banks to truncate original checks, process check information electronically, and deliver substitute checks to banks that want to continue receiving paper checks. A substitute check is the legal equivalent of the original check and includes all the information on the original check. The law does not require banks to accept checks in electronic form or to create substitute checks.

All paper negotiable instruments, including money orders, may now be processed electronically, allowing managers to accelerate cash collections because they can deposit checks faster and more efficiently.

The original items must be retained in a secure location for a minimum of 14 days in case there is an issue with image quality. The imaged checks must then be destroyed to ensure that they are not later reintroduced into the transaction clearing system.

Check Electronification Process



1. Paper items are scanned on-site or at a centralized location to capture images of each item.
2. The images and associated data are processed within a payments gateway through a series of dynamic decision tools that determine whether each item may be converted to an ACH transaction or whether the payments should be processed in accordance with the Check 21 framework.

3. Items that qualify for an ACH transaction are transmitted to the ODFI in accordance with standard processes. Other items are submitted to the resident's (the payer's) bank either as electronic images or as substitute checks for payment to the manager's (the payee's) bank via the reconverting bank. The bank may hold up funds for up to two business days, depending on the banking relationship established by each manager.
4. If the paying bank cannot post the items for payment, it will return the payment to the reconverting bank, and the return will be debited from the manager's operating account designated for Check 21 processing. Returns may be received for up to 60 days.

Check electronication fees include per-item fees, monthly account fees, reporting fees, return item fees, and image-hosting fees. Both the image processor and the ODFI may charge fees. Fees are typically debited from the owner's account and credited to the processors monthly.

LOCKBOX SERVICES

Third-party providers and banks offer lockbox or remittance-processing services. These providers collect payments from a dedicated postal box to which clients have directed their customers to send payment. Remittance providers make several mail pickups per day, process the payments immediately, deposit the funds, and provide information, including images of checks and remittance documents, to update clients' receivables.

The location of a lockbox processing center is an important consideration. Selecting multiple regional lockbox locations speeds the delivery of payments from payers nationwide. This approach, however, increases operating costs because it requires multiple deployments of a customer's database and reporting framework. Most apartment managers will need only a single, centrally located lockbox facility.

Faster collections, streamlined payments processing, improved transaction reconciliation, and fewer errors are among the benefits of lockbox services. Lockbox options are offered based on the type and volume of remittances. They can be tailored to match a manager's internal processes. Typically, funds are applied, collection reports are updated, and checks are deposited the day funds are received.

Wholesale lockboxes automate the collection and reporting of low-volume, high-dollar-amount remittances—in the range of 1,000 to 10,000 items per month. Retail lockboxes are designed to collect and report high-volume, low-dollar-amount remittances. Lockbox operators will develop custom wholesale solutions to meet the specific needs of apartment managers.

A lockbox typically requires the delivery to payers of a remittance advice that is returned with payment via U.S. mail. Payments processing times are therefore longer than other automated payment options because of mail time for receipt of payments.

Lockbox fees include per-item fees, account fees, reporting fees, return item fees and image-hosting fees. Fees are typically debited from the owner's account and credited to the operator's account monthly.

PERSON-TO-PERSON PAYMENT SERVICES

With the rise of e-commerce and the launch of PayPal in 1998, a number of person-to-person payment services have appeared. PayPal, now an eBay company, is the undisputed leader in this sector. The company services 78 million account members worldwide, enabling transactions in 56 countries and among buyers and sellers on eBay, online retailers, online businesses, and traditional offline businesses.

The PayPal service enables any individual or business with an email address to send and receive payments online securely, easily, and quickly. PayPal's service builds on the existing financial infrastructure of

bank accounts and credit cards and uses an advanced proprietary fraud prevention system to support safe, global, real-time payment.

PayPal should be considered a payment alternative on a par with VISA and MasterCard acceptance. However, using PayPal requires a separate registration for each payer and payee, and the service is not typically integrated with payment gateways. PayPal enforces operating rules that are comparable to the compliance guidelines of the credit card associations.

Transaction fees are consistent with interchange fees for bank card acceptance. Monthly fees may apply for certain business accounts.

BANK BILL PAYMENT SERVICES

Bill consolidation or “bank bill payment” is popular among consumers. They are offered an integrated platform with common interface, typically on Web sites of national banks that consolidate bills from multiple sources. Consumers view this consolidated presentation, the automatic tracking of due dates, and the elimination of paper statements as substantial benefits.

The consolidator can complete payments by automatically creating and mailing actual paper checks or via ACH, credit card, and debit card transfers. It has been estimated that 40 percent of payments made on behalf of consumers through this channel are still fulfilled by check, with approximately 60 percent completed electronically, mostly through the ACH system.

This model is often more complicated to adopt than the biller-direct models described in this White Paper, since the consolidator must collect and enter biller information from different sources that often employ different means of presenting billing and contact information. If a biller is not listed on the bill payment network, funds are disbursed by mailing paper checks to the biller, impairing the benefits of accelerated funding otherwise offered by this method.

In the apartment management industry, this delay exposes residents and managers to significant challenges—a resident may believe that a payment has been made, but the check is actually in the mail and may be received after the due date, with the resident incurring late charges. Another important consideration is the need to list each community on the network to ensure that funds are correctly disbursed to each community’s depository account, not to a centralized concentration account.

A range of consolidator services have been launched to make access to “bank bill payment” easier for billers and to ensure ACH payment through permanent listing on the bill-pay networks.

Fees include per-item fees, monthly account fees, and a one-time setup fee for each account listing.

CONVERGENT BILLING AND PAYMENT

The concept of “a single bill and a single payment” offers simplicity and convenience to the payer and payee, and with the advance of statement billing systems, the apartment industry is now able to adopt this approach. A consolidated resident bill (delivered by mail or electronically) combining rent, utility, and related charges, coupled with multiple payment options, helps to ensure accurate, on-time payments.

Many managers have replaced monthly utility-only bills with convergent bills showing the itemized amounts due at the time of issuance. These bills may include a remittance slip and return envelope, allowing payment via mail to a lockbox or on-site drop box, online, or by phone.

A well-designed convergent bill will help residents understand exactly what they owe and that they must pay their monthly balance in full when they pay their rent. The system can reduce the time property man-

agement staff spends tracking down small balances, increase resident satisfaction and improve property collections.

Convergent bills can also include messages from property managers to residents, such as invitations to community events or general property-wide announcements or reminders. They are a cost-effective means of communicating with residents.

Convergent billing can reduce managers' cost of processing transactions. Managers can achieve post-transaction reconciliation and apply the funds collected to specific line items in an integrated data environment at a fraction of the cost of dealing with separate payments.

IMPLEMENTATION ALTERNATIVES

To maximize the benefits of an automated electronic payments strategy and convergent billing, the system must offer an easy-to-use, data-rich environment that integrates with property management and accounting systems and tools.

Interpreting and reconciling data from transaction processing and bank statements is one of the significant challenges that property managers face when accepting electronic payments. Most community managers and accounting staff state that they are seeking transaction data and reports that are accurate, relevant, and meaningful—not batch reports of settled transactions, but line-item details searchable by standard property management terms (resident name, resident ID, etc.) through easy-to-use interfaces.

Leading providers of payment services have responded to these needs by creating “contextual environments” for processing, reporting, and reconciling payment transactions. They have added proprietary user interfaces, data fields, and reports to standard payment transaction processes to make automated electronic payment systems easier to use. Such systems deliver enhanced generic payment transaction reports with relevant reference data, searchable by standard industry terms.

The systems add further value through integration with property management and accounting software packages. By leveraging XML and Web services, certain transaction processors offer application programming interfaces (APIs) and professional services for custom integration with various management and accounting packages. Similarly, vendors of accounting and management software have published APIs for efficient integration and may offer “built-in” payment service functionality as part of their extended services. Vendors and processors realize that their customers—managers and owners—require accurate data, and they generally do their best to enable integrations that meet customer requirements.

Commonly selected Integration options include the following:

1. Direct integration
 - Proprietary Web service programming interfaces to management systems and Web sites.
 - Direct integration delivers maximum compatibility, security, and real-time access to the latest enhancements.
2. Data exchange interface integration
 - Common data exchange interfaces between third-party systems to enable integration for common customers.
 - Integrations are commonly performed with the support of the third-party systems developer, on the request of each common customer, to ensure ongoing customer support and high levels of systems availability.
3. File integration
 - File-based data exchange through the secure import and export of system files.

- Files are generated in custom formats that fit the database structure of the customer's existing system.
4. Customized reports/formats
- Customized reports to meet each manager's back-office reconciliation needs.
 - Reports include payment transaction detail reports, bank activity reports, and merchant statement summaries for both data import and audit purposes; reports can be generated as needed or periodically.

It is anticipated that the apartment industry will gather support for a payment services integration standard based on the National Multi Housing Council's Multifamily Information and Transactions Standard (MITS). Managers who wish to integrate multi-vendor solutions and services without the need for proprietary tools should welcome such a standard. However, the success of the standard will depend on its adoption and on cooperation among vendors and service providers. The industry, as the customer, has the demand-side power to drive toward the desired results.

When evaluating a suitable integration approach for automated electronic payments, managers should consider their business strategies, current processes, operating goals, and user preferences. Tightly integrated systems are not suited to all business environments.

Answers to the following questions will drive integration decisions:

1. Is the current management and accounting system owned by the apartment or hosted by a service provider?
2. Is the current management and accounting system capable of accepting automated transaction data?
3. Does the current system allow data exchange from outside the firewall? If so, via which modes?
4. Does the owner operate more than one management and accounting system across the portfolio? If so, will more than one integration be required between payment systems and management systems?
5. Will automated data exchange lead to process enhancements and quantifiable cost savings (for example, by reducing the time on-site personnel spend manually capturing transaction data)?
6. Will automated payments and data integration impact other key business processes and require more process changes?
7. Does the current system comply with association and banking industry data security and privacy requirements?
8. Is an information technology (IT) department available to participate in an integration project?
9. Will the existing management and accounting systems be retained long enough to realize the benefits of integration?
10. What time frame has been established for the implementation of an automated electronic payments system?

BUILD OR BUY?

To build or to buy is a critical decision when developing and implementing an automated electronic payment system. Given the compliance and regulatory oversight of the apartment industry, there is no room for compromise in security, accuracy and quality of service. When faced with fast-track implementation

schedules and competing strategic development initiatives, managers often outsource the development, deployment, and maintenance of their payment systems. Among the “build or buy” options are the following:

- *In-House Development*
Internally developed, implemented, and maintained systems, designed to meet the specific requirements of the internal customer, are popular among companies with scalable internal development groups and significant IT budgets. In addition to the development of the payments system, a direct relationship with banks and transaction processors is required. Compliance and reporting are managed internally. A range of established “off-the-shelf” gateway products are available to support in-house development initiatives.
- *Managed Services*
Vertically focused managed payment services are available for apartment managers. The services include multiple payment types, integration interfaces, and reporting. Service providers also offer pre-packaged banking relationships, compliance and chargeback management, as well as system maintenance, training, customer service, and marketing services. These service offerings are a relatively affordable, low-risk option.
- *Custom-Managed Services*
Custom-managed services available from certain providers combine the benefits of in-house development and a standard managed service offering. These providers offer customization and integration services to enhance their standard service offerings and payment alternatives. All elements of the service are customizable, including user interfaces, data exchange formats and processes, reporting tools, and funds disbursement models. Custom-managed service offerings support the development of solutions that meet specific business processes and requirements, backed by the experience and infrastructure of payment service specialists.

Answers to the following questions will determine the “build or buy” decision:

1. Do the in-house developers have the relevant experience?
2. What is the time frame for completion of the deployment?
3. Does the IT group have the capacity to manage the service on an ongoing basis?
4. Will this implementation impact other strategic projects?
5. What level of support services is required?
6. Will customization be required?
7. Have the treasury, accounting, and operations teams identified specific product and service requirements to support their activities?
8. Is multiple platform integration required?
9. Does the budget support the proposed implementation investment?

Whatever the “build or buy” decision, certain services and products will be required. Vendors should meet the following criteria:

1. Competitive, all-inclusive cost structure for technology and processing services
2. Multiple payment types across multiple channels

3. Compliance with credit card association and banking industry rules and security requirements
4. Direct funds disbursement to direct deposit accounts for each property and no commingling of funds
5. Online access and customizable report generation for all payment transaction data
6. Customizable user interfaces
7. Efficient and accurate post-transaction reconciliation, particularly when funds collected exceed gross amount payable because of convenience fees
8. Convergent billing and payment
9. Integration with property management and accounting software
10. Fraud and risk management tools
11. Direct relationship with a Federal Deposit Insurance Corporation (FDIC)-insured financial institution
12. Separate merchant accounts for each community
13. Dedicated customer service and chargeback management assistance
14. Virtual terminal- and phone-based payment channels
15. Hardware warranty and replacement program
16. Customized training for all users
17. Demonstrable expertise and customer references
18. Dedication to the property management industry with a focus on payment services
19. Incentive programs to increase online payment adoption rates among residents
20. Custom marketing and promotional materials for each customer

COMPLIANCE

On the surface, automated payments collection is a win-win situation for property managers and residents alike. Lurking just below the surface, however, are several significant issues. Automated payment solutions that do not comply with local laws, bank card association rules, and commonsense business practices can be risky and counterproductive. Compliance should not be treated as a luxury option but as the starting point for any credible automated payments solution.

Noncompliant payment solutions may expose property managers to risks, fraud, and malicious network attacks; termination of merchant processing agreements; and state and federal penalties. They place residents in a situation where their privacy, credit ratings, and quiet enjoyment of rental properties may be impacted, especially if owners or managers fail to receive residents' payments. To protect consumers and investors, defend the integrity of national infrastructure and systems, and maintain acceptable business standards, regulators have implemented credit card association rules, state and local real estate laws, and federal legislation covering fair housing, fair credit reporting, and accounting practices.

Regulators are taking a strong proactive stance in defining the rules and processes that constitute compliance. In some cases, these rules have resulted in third-party online payment services losing their ability to process credit cards such as VISA and American Express. In other cases, state departments of real estate have mandated that only licensed brokers or property owners, and not third-party payment aggregators, may receive funds paid by residents under the terms of a lease agreement.

The message is clear: managers and owners are advised to take compliance seriously and to select their partners wisely.

Service/Issue	Description	Comment
Aggregation	Some third-party service providers process credit card and check payments for property managers on an aggregate basis, through a single account controlled by the service provider. Once the funds have cleared and are deposited in the service provider's account, the service provider will transfer funds to the manager's trust account.	This service model is not compliant with VISA rules. Any merchant seeking to accept payment by credit card is required to enter into an agreement with an authorized member bank. This approach protects merchants from third-party providers who aggressively hold and have liability for merchant funds. It also protects consumers who are unaware that they are not paying a merchant directly.
Control of Funds	Certain third-party aggregators have sole control over funds paid in favor of property managers and manage a disbursement process that is outside of the standard merchant account system. The processors control the funds at all times prior to disbursement to the manager.	This service model is not compliant with real estate laws in many jurisdictions, because the managers do not control the processing accounts, and loss of control is considered to be a breach of trust account compliance. Additionally, all trust-related accounts must be clearly described as such in banking records.
Banking Relationship	<p>Before accepting VISA or MasterCard payments, a manager is required to establish a merchant account with an authorized acquiring bank or a registered independent sales organization (ISO) or member service provider (MSP) of the bank.</p> <p>American Express and Discover require direct contracts with merchants. Only authorized merchants may accept payment by credit card.</p>	Only representatives of an acquiring bank or a registered ISO/MSP can present merchants with a Processing Offer and Merchant Account Agreement. Unless managers contract directly with the bank through official sales channels, the solution may not establish a binding relationship between their business and the acquiring bank. As a result, managers and residents will have no banking industry protections.
Commingling of Funds	Commingling of funds occurs when funds belonging to several entities are mixed in a single account. Certain lenders and housing assistance organizations enforce strict covenants that preclude the commingling of any rental income paid by residents of a property with other funds. Additionally, states that regulate trust accounting practices have ruled that commingling constitutes a breach of the trustee's fiduciary duties.	Compliance is achieved by maintaining separate merchant accounts for each community under management, and ensuring that clear disbursement instructions are implemented when these accounts are established. Unrelated funds from multiple properties should never be settled in a single merchant account.

<p>Convenience Fees</p>	<p>In an attempt to offset the costs of processing online transactions, certain managers charge residents convenience fees. These fees are often applied arbitrarily and inconsistently.</p> <p>The credit card associations, VISA and MasterCard, as well as issuers of non-bank cards, enforce a wide range of regulations on card-accepting merchants through member banks that offer credit card processing services. Failure to comply with these rules can result in fines and the termination of processing privileges.</p> <p>The associations and certain states restrict the charging of surcharges on credit card transactions. A surcharge is a penalty assessed when a more expensive means of payment is selected over a cheaper option (e.g., credit card instead of cash). A service fee or convenience fee applied across <i>all</i> payment types in the alternative channel, for the purposes of covering costs of the channel, is legal.</p>	<p>Convenience fees are compliant with association rules only when the fee is imposed on transactions in the same alternative channel regardless of the form of payment used, and the fee is a flat or fixed amount regardless of the value of the payment.</p>
<p>Sarbanes-Oxley</p>	<p>Section 404 of the Sarbanes-Oxley Act of 2002 requires that publicly traded companies establish, document, and maintain internal controls and procedures for financial reporting. It also requires companies to check the effectiveness of those internal controls and procedures.</p> <p>Companies must document controls and procedures that relate to financial reporting, test their effectiveness, and report on any gaps or poorly documented areas.</p>	<p>Compliance is achieved by recording and reporting transaction data at each stage of a transaction, from initial authorization through settlement and ultimate funds disbursement. Additionally, it is important to disburse funds directly to the intended deposit account for the business function, and not via unrelated commingled accounts.</p>
<p>Statement on Auditing Standards (SAS) No. 70</p>	<p>Statement on Auditing Standards (SAS) No. 70, <i>Service Organizations</i>, is an internationally recognized auditing standard developed by the American Institute of Certified Public Accountants. It represents that a service organization has been through an in-depth audit of its control activities, which generally include controls over information technology and related processes. Service organizations or service providers must demonstrate that they have adequate</p>	<p>Section 404 of the Sarbanes-Oxley Act makes SAS 70 audit reports even more important to the process of reporting on effective internal controls at service organizations. Managers should request a SAS 70 letter from their acquiring bank or ISO/MSP to satisfy compliance obligations.</p>

	controls and safeguards when they host or process data belonging to their customers.	
Data Security	<p>When residents offer their bankcard at the point of sale, over the Internet, on the phone, or through the mail, they want assurance that their account information is safe. That is why VISA USA has instituted the Cardholder Information Security Program (CISP) and MasterCard has mandated the Site Data Protection (SDP) Program. These programs are intended to protect cardholder data wherever it resides, ensuring that members, merchants, and service providers maintain the highest standards of information security.</p> <p>To standardize compliance, VISA and MasterCard collaborated to approve the Payment Card Industry (PCI) Data Security Standard, which offers a single approach to safeguarding sensitive data for all card brands, incorporating the CISP and SDP requirements. Other card companies operating in the United States have also endorsed the PCI Data Security Standard.</p>	<p>All merchants and their processors are subject to strict compliance with these rules. Equally significant is the validation of compliance. It is a fundamental and critical function that identifies and corrects vulnerabilities, and protects customers by ensuring that appropriate levels of cardholder information security are maintained. VISA and MasterCard have prioritized and defined levels of compliance validation based on the volume of transactions, the potential risk, and exposure introduced into their system by merchants and service providers.</p> <p>Managed payment service providers and ISOs/MSPs of major acquiring banks are required to comply with association rules, including these data security rules. Thus, managers processing transactions through these services can benefit from their “built-in” compliance and conduct their business with the knowledge that their data and their customers’ data are secure and confidential.</p>

UNDERWRITING AND DOCUMENTATION

Merchant and payment processing accounts at an acquiring financial institution are required to process most automated electronic transactions. These accounts represent an unsecured line of credit from the bank. Like all lines of credit, the merchant’s account is subject to both an initial credit approval and periodic rate reviews.

In order to evaluate credit risk, banks and transaction processors have established underwriting processes that require strict adherence. Generally the underwriting process comprises the following steps.

COMPLETION OF MERCHANT APPLICATION

A Merchant Application is an in-depth form developed to obtain required underwriting and compliance information. The rigid underwriting processes at most transaction processors require the submission of a “complete application package.” In order to ensure quick underwriting approval and account setup, managers should complete all sections of the application document and not obliterate or modify any sections of the document and associated terms. When in doubt, managers should contact their account representative at the institution.

AGREEMENT TO TERMS

Standard Merchant Applications incorporate by reference the terms of a Merchant Agreement. Managers should be sure to receive and review the Merchant Agreement. It is a legally binding document that a mer-

chant accepts upon submission of the Merchant Application, and it may contain terms that restrict a merchant's rights and impose certain obligations. Common terms to review and consider include the following:

1. *Exclusivity*

The merchant agrees to process all transactions through the processor for the term of the agreement. Exclusivity may conflict with existing obligations and relationships.

2. *Security Interest*

The merchant agrees to grant a security interest in depositary accounts into which funds that are processed through the processing relationship are deposited. This security interest is a common requirement in order to secure the credit-based relationship that is being established between the processor and the merchant. However, such a requirement may be unacceptable to owners and managers; if so, it should be negotiated. It may be possible to agree to an alternate form of security or engage with a processor that does not require it.

3. *Compliance*

Compliance with the data security, privacy, and operating regulations of the bank card associations, nonbank card companies, and NACHA, as well as applicable federal, state, and local law, is imposed on merchants by the Merchant Agreement. The PCI Data Security Standard offers a single approach to safeguarding sensitive data for all card brands. Managers should ask their processors which specific regulations apply. Many processors include the complete text of the applicable "rules" in the Merchant Agreement. Providers of managed services will include compliance in their service offerings.

4. *Liability*

The merchant will be liable for any losses, fines, assessments, chargebacks, or returns incurred during the term of the agreement. This liability continues for up to six months following the closure of any accounts or termination of the agreement. Credit card payers may charge back transactions at any time within six months of a transaction.

5. *Early Termination*

Processing rates are calculated based on projected transaction volume and value for the entire term of the agreement. An early termination will result in loss of profit for a processor, if not a loss on the relationship as a whole. Many processors require the payment of an early termination fee calculated as a percentage of expected revenues for the relationship, reducing in magnitude as the term progresses. Providers of certain advance processes that focus on apartment management have waived early termination fees.

A "COMPLETE" DOCUMENT PACKAGE

Transaction processors and banks are subject to increasing federal regulation and are required to obtain increasing amounts of information on customers. At first glance the information these processors request may seem unreasonable. However, the USA PATRIOT Act and other financial institution operating regulations dictate the terms of these requests, which may not be waived.

USA PATRIOT Act Notice

Today most processing agreements contain a USA PATRIOT Act disclosure, for example: "To help the government fight the funding of terrorism and money laundering activities, the USA PATRIOT Act requires all financial institutions to obtain, verify, and record information that identifies each person (including business entities) who opens an account." When a merchant opens an account, the processor will ask for the name, physical address, date of birth, taxpayer identification number, and other information of the merchant and principals. The processor may also request a driver's license or other identifying documents.

Underwriting Goal: Know the Customer

To comply with FDIC regulations to prevent money laundering and criminal acts and to correctly assess the risk associated with any customer account, processors try to determine the what business their cus-

tomers are engaged in and their "normal and expected" transactions. The underwriting review for each new account application may include requests for the following items:

- Social Security number and home address of signing officer
- Credit reports for each principal
- Complete financials for the specified period
- Accuracy of information
- Technology review

The extent of the request may depend on the projected annual transaction volume. The following is an example of required documentation to support the underwriting process at a leading national bank:

- 1) Under \$240,000 annual projected payment volume
 - i) Articles of Incorporation
 - ii) Three months' consecutive recent merchant processing statements (if applicable)
- 2) \$240,000–\$1,000,000 annual projected payment volume
 - i) Articles of Incorporation
 - ii) Three months' consecutive recent merchant processing statements (if applicable)
 - iii) Corporate overview
 - iv) Business and/or personal financial statements, including tax returns
- 3) Above \$1,000,000 annual projected credit card processing
 - i) Articles of Incorporation
 - ii) Three months' consecutive recent merchant processing statements (if applicable)
 - iii) Corporate overview
 - iv) Full-year financial statements, balance sheet, and profit and loss statement

RISK FACTORS

The credit basis for establishing transaction processing accounts with merchant processors makes it important to consider the essential risk factors that are measured when an application is underwritten:

- *Processing Volumes*
Applicants should provide accurate estimates of processing volume, or actual volume if they are already processing transactions electronically. Significant variances from projected volumes may delay the disbursement of funds or cause the processor to reassess the banking relationship. Processors determine rates, security deposits, and other material terms on the basis of processing volume.
- *Chargeback, NSF History*
An applicant's chargeback and NSF history provides important data to underwriters on the risk for a new account. The historic industry average for chargebacks in the property management sector is less than 0.5 percent.
- *Business History and Financial Strength*
Key to knowing a customer and understanding exposure to risk is an in-depth review of the applicant's business history and full disclosure of the financial strength of the customer and its principals. Private companies may undergo a more thorough review than publicly traded companies, because they lack public reports and regulation compared with publicly traded peers.
- *Technology*
Underwriters will review an applicant's technology systems and the vendors of such services. Given the need to comply with association, NACHA, and state data and privacy rules, knowledge that an applicant implements compliant products and services is central to underwriting approval.

CONTRACT NEGOTIATION AND RISK MITIGATION TOOLS

While the transaction processing relationship and the establishment of processing account is based on the creditworthiness of the applicant, it is also a business relationship and may, like any business transaction, be subject to negotiation by the parties.

Managers should thoroughly review and understand the Merchant Agreement and negotiate when terms do not meet their business objectives. It is also advisable to seek transaction-processing solutions from vendors and processors that specifically serve vertical markets and tailor solutions to meet the requirements of customers in these markets.

In certain circumstances, underwriters' concerns regarding the creditworthiness of applicants may be addressed by offering the following forms of security:

- Certificate of deposit—often held at the acquiring bank in the name of the merchant and pledged to the bank
- Personal guarantee—acceptable for low-volume, lower risk merchants
- Corporate guarantee—acceptable for U.S. corporations where the parent can demonstrate financial strength to mitigate the credit exposure
- Irrevocable letter of credit—based on ratings from the International Data Corporation, FDIC, or Sheshunoff Information Services
- ACH funds disbursement delay—acceptable for low-volume, lower risk merchants
- Rolling cash reserve—an ongoing adjusting reserve based on actual transaction volume
- Cash reserve—an accrual-based reserve tied to actual recurring payment authorizations

TOP TEN CONSIDERATIONS

The following questions cover material considerations for apartment professionals planning an automated electronic payments implementation:

1. Has the company defined the payment options it intends to offer?
2. Will the company require custom services, such as payment by phone?
3. What level of data integration with existing management and accounting systems is required?
4. Has the format of payment systems reports that will support existing business processes been defined?
5. Will a convergent billing model that will accept automated payments for utilities and other services be implemented?
6. Does management understand compliance?
7. Will convenience fees be charged?
8. Is more than one merchant account per community required?
9. How will automated payment options be marketed and promoted to residents?
10. Has a rollout plan been developed?

CONCLUSION

Over the past year, an increasing number of apartment managers have initiated automated electronic payments projects. They are responding to consumer demand and benefiting from the business benefits of automation.

With the advance of Web-services technology and the development of industry standards, payment service providers have become more responsive to the needs of the apartment industry and offer customized solutions that will match the industry's business processes. Apartment managers should demand customization and integration with existing systems and should negotiate with processors on matters including fees, underwriting criteria, and security.

The acceptance of electronic payments will become an industry standard over the next two years and will transform the industry's business processes. However, getting there will require standardization, knowledge, planning, and vendor partnerships. Decisions about business processes and strategies decisions must precede vendor selection.

Early adopters will achieve short-term competitive advantages. The winners in the long term will achieve process enhancements that drive profitability.