

# Delinquent Tenant Receivables in the Residential Real Estate Sector Offer Frequently Overlooked Revenue Potential



**Lutz Rittig**  
Managing Director  
RITTERWALD

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Large real estate companies are always having to deal with tenants in arrears. Despite internal dunning and eviction procedures they still have to write down millions in unpaid rent and utility charges. But delinquent, written down receivables are not fundamentally worthless – in fact they offer long-term revenue potential in many cases. Once they are legally enforceable claims (i.e. have been declared as legitimate receivables in a court of law) the statutory limitation period extends to 30 years.

Residential real estate companies have various options they can take when deciding which strategic position to adopt on receivables management:

1. No longer pursue delinquent receivables from debtors from whom payment could not be elicited even after legal proceedings (e.g. personal bankruptcy)
2. Engage debt collectors to collect the receivables
3. Make up “packages” of written down receivables and sell them off (factoring). This can be done on a rolling basis (e.g. all receivables falling due on a monthly or quarterly basis) or they can be put into one large package and sold to clear bad debts

The option of engaging a conventional debt collection agency cannot be recommended unreservedly from a busi-

ness perspective for a residential real estate company. Total receivables from each (former) tenant usually amount to several thousand euros. Particularly when you have tenants who have been through dunning procedures, forced evictions and court cases, the tenants may be on the verge of personal bankruptcy in many cases. They may have moved away without leaving a forwarding address as a result, or they may only be able to pay off the debt in very small installments (e.g. 10–20 euros a month). The prospects of the total claim being paid back in the short to medium term is consequently very low. Not only that, but there is the distinct possibility of the real estate company suffering damage to its image as a result of being connected with debt collectors. Instead

of pursuing the few promising cases internally or with a local collection agency for moderate success, factoring offers a better option.

### Factoring as an alternative to debt collection

Factoring involves a company (continually) selling its receivables to a specialist service provider. Member companies of the German Factoring Association saw their combined revenues exceed 200bn EUR for the first time in 2015. Although it must be said that the vast majority of factoring revenues have nothing to do with delinquent receivables that have been through the dunning procedure.

Normally, the procedure in factoring is as follows: The company selling the



	<b>Factoring</b> – Sale of written down rental receivables from residential real estate companies	<b>Debt collectors</b> engaged by residential real estate companies
<b>Advantages</b> 	<ul style="list-style-type: none"> <li>• Immediate, significant liquidity inflow</li> <li>• One less job for accounts receivable/dunning team to do</li> <li>• Buyer assumes all further collection risk</li> <li>• Clears bad debts and has a positive impact on the bottom line</li> </ul>	<ul style="list-style-type: none"> <li>• Reduces payment default</li> <li>• Regular, small liquidity inflows</li> <li>• One less job for accounts receivable/dunning team to do</li> <li>• Collection costs paid by debtor if debt successfully collected</li> </ul>
<b>Disadvantages</b> 	<ul style="list-style-type: none"> <li>• Receivables are sold at a discount (87–98% of the original total receivables being paid)</li> </ul>	<ul style="list-style-type: none"> <li>• Collection costs may need to be paid by real estate company if debt cannot be collected</li> <li>• Bad debts that cannot be recovered over a long period incur court/inventory costs</li> <li>• Possible negative image transfer from the poor image of debt collection in general</li> <li>• 30–60% success fee payable to debt collector</li> </ul>

Fig. 1: Comparison of factoring vs. debt collection from a residential real estate company's perspective

receivables (e.g. a trading company, manufacturing firm or service provider) signs its receivables over to a factoring company as soon as the respective invoices have been raised. The factoring company then pays the seller 80–90% of the total receivables immediately and subsequently takes care of the incoming invoice payments itself – including accepting the risk that the debt may be defaulted on (collection risk).

So as we can see, regular factoring does not represent a compelling option for a residential real estate company – after all, it's clear that landlords don't need external help with monitoring their incoming rental payments. However, the factoring market is very diverse and some providers have specialized in the niche market of buying distressed receivables. And among them, certain expert firms are specifically targeting real estate and utility companies.

#### Large packages of rental receivables are in high demand among factoring firms

Germany's healthy economy means that payment practices are generally better than average here and the demand for receivables portfolios exceeds supply. The low interest rate environment me-

ans that many of the big factoring firms can refinance their debt at low cost and are willing to pay attractive prices to real estate companies selling off their receivables in auctions or tendering procedures.

#### Added value with RITTERWALD

RITTERWALD has very good knowledge of relevant market players and service companies and supported one of Germany's leading municipal housing companies in selling their written down tenant receivables (15m EUR in total receivables from 5,200 debtors) in a structured bidding process. Of the 27 market players identified, 11 were contacted and competitive negotiations were entered into with 3 bidders. Ultimately, the receivables were successfully offered to the best bidder – a professional and reputable factoring company – without attracting any public attention. The attractive price paid for the portfolio of written down receivables improved our client's bottom line in the form of a one-time effect.

Do you have questions regarding this topic?



#### Martin Eisenberg

Vice President

[martin.eisenberg@ritterwald.de](mailto:martin.eisenberg@ritterwald.de)

+49 69 / 78 80 88 02 12

Martin Eisenberg is Vice President in the Frankfurt office, where he specializes in mergers & acquisitions and company valuations for mid cap firms in German-speaking Europe. His work also focuses on strategy consulting for clients in the real estate sector, particularly strategic realignment, and the establishment of new business lines and subsidiaries.