

# The FICO Fallout

BY PAUL R. BERGERON III

*Owners should be leery of resident screening models that overweight the value of FICO scores, supplier partners say.*

**M**any apartment owners nationwide, given their pursuit of filling available units with qualified and reliable residents, may have frowned upon learning last month that more than one-quarter of Americans (43 million) hold FICO credit scores of 599 or less, which reflects poor risk for lenders.

This potentially worrisome news is even more troubling in light of FICO Inc.'s report that in the past, typically only 15 percent of consumers were in this high-risk category. Under the tighter lending standards banks now use, the Associated Press reported July 12, it is unlikely these people will be able to get credit cards, automobile loans or mortgages.

Based on consumer credit reports as of April, FICO confirms that there has been an increase of about 2.4 million people in the lowest credit score categories over the past couple of years.

Many resident screening supplier partners strongly suggest that FICO scores should not be the primary factor owners consider when deciding to rent to prospects. Many aspects of FICO's scoring do not serve apartment owners' interests well.

FICO is based on the consumers' ability to pay. Jorge Baldor, President, ResidentCheck, says it is more important to understand and measure an applicant's willingness to pay through multiple criteria. His company uses a proprietary, statistical credit-risk model developed for the multifamily housing industry and does not rely on FICO.

"By checking collections records, owners can find that some prospective residents are able to pay but simply do not, making them a higher risk," Baldor says. "Finding the balance between occupancy demands and bad debt risk should be the basis for all screening models."

Owners should ask their screening company if FICO plays any part in the scoring model and should request clarification of how it is used, Baldor says.

Baldor says it is his experience that many screening companies use the FICO model and rename or tweak it for marketing purposes. "Many are now distancing their models from claiming they are based on FICO," Baldor says.

## Positive Opportunities for Owners

The recent FICO data presents a positive opportunity, says Jay Harris, Vice President, Business Services, CoreLogic SafeRent.

"This jump in (sub-599) FICO scores is potentially a big positive for rental housing providers," Harris says. "They can benefit from the inability of their residents and prospects to qualify for mortgages today that they could have qualified for two years ago."

In contrast to FICO, statistically validated rental housing scoring models that are using key, non-bureau rental housing data have been steadier, Harris says. "They have not experienced FICO's wide variance in low-scoring applicants," he says. As a result, those models enable operators to more accurately price rental applicants' credit risk and qualify more applicants at less risk, he explains.

Some screening providers have developed statistical models (similar to a FICO score) that better predict the risk associated with consumers who apply for rental housing, says Linda Richer, Director of Resident Screening, AmRent. Use of these industry-specific models normally provides a better risk predictor than FICO. Another flaw is that FICO doesn't take into account eviction court records.

Using FICO scores as a predictor of how a consumer will pay rent is risky, Richer says. "Models like FICO never took into consideration length of employment, income or other factors that most management firms require," she says. "Using a screening company's judgmental decision model, property managers have the ability to incorporate critical impact factors like debt-to-income ratio into their approval process."

Property owners and managers must shift their focus to those with lower credit scores or thin-file or no-file credit histories because these markets represent many untapped, rent-worthy individuals, says Pam Storm, Vice President & General Manager, LexisNexis Resident Screening.

She says owners and managers can use technology-based data analysis to target applicants who may have been rejected by previous scoring methods. Non-traditional credit scoring relies on detailed analysis of positive and derogatory life events, evidence of assets and address stability, positive identity verification and public records such as employment and marital histories.

These non-credit data sources record historical information about an individual that is analogous to traditional credit history, providing relevant information about the economic lifestyle of an individual. This approach, often used in the financial industry, should prove to be effective. ■■

## Problems With FICO Scores

- FICO considers the past seven years in its score. Because the multifamily industry credit population is younger than the national average, what happened five, six or even seven years ago in someone's credit history has little relevance. This is even more important now when considering the credit crisis felt nationwide over the past two years. Owners could gain by considering only the past 24 months, giving applicants' scores greater relevance.
- FICO is based on national credit trends, whereas a screening product should base its product on individual credit performance and risk, regardless of national trends.
- FICO was developed for the credit card and mortgage industry. Multifamily factors are not weighted and often result in an approval even with prior housing debts.

Source: ResidentCheck