Credit Trends and Resident Screening

By: Jorge Baldor

Credit trends have been affected by the economy and the economy has been affected by credit trends. Spiraling consumer spending and unregulated lending led to an almost euphoric feeling that the good times would last forever. That is until September 2008, when consumer debt reached its peak and credit usage halted, either by the consumer voluntarily or by stricter credit and lending standards. At the end of 2010 consumer debt was reduced $1.08 trillion, or about 8.6%, according to the Federal Reserve Bank of New York who recently started tracking detailed consumer credit data along with the credit rating agencies and February 2011 reports show 401K's have the highest balances in 10 years.

This rapid debt reduction, coupled with an increase in personal savings from 2% to about 6% in the past 3 years, reflect the radical shift in credit usage trends that has occurred since the recession began at the end of 2007. According to national credit screening providers, the trend for multifamily applicants has been reported at about a 5% improvement of credit scores in 2010 from the previous year. However, while the number of credit card accounts declined about 23% from July 2008 to late 2010, and the average balance was reduced by 16%, this downward trend also seems to have peaked. By late 2010 and early 2011, the personal savings rate has dropped to 5.8% and consumers are rapidly increasing non-mortgage borrowing.

Responsible credit usage trends has its advantages for individual consumers but the timing couldn't be much worse for an economy dependent on consumer spending as it struggles to recover and create jobs. American markets have also been considered the salvation for foreign companies looking outward to sell products when their own local markets have vanished. This has an impact on multifamily, as the biggest concern for renters has been tied to the increased unemployment triggered by the recession at home and globally.

Just as the unsurprising hindsight realization that unqualified borrowers became delinquent or simply walked away from credit obligations, many property owners and management teams have realized that lowering credit approval standards to offset lower occupancy has negative consequences. Resident screening plays a key front-line role in guarding against "preventable" bad debt.

Even though experience has shown otherwise, resident screening is often viewed as separate from delinquency and bad debt when setting applicant approval guidelines. This leads to a see-saw effect of focusing on occupancy until bad debt rises and then the cycle reverts to raising credit standards again until occupancy drops.

The role of a resident screening partner is to understand credit trends and adjust their model to successfully work with the client's own portfolio and find the balance between occupancy demands and bad debt risk tolerance. National credit trends that cannot be measured or that are not relevant to multifamily, like credit score models based on the credit bureau designed FICO scores, must be reexamined.

Resident screening and bad debt collection combine to provide the "whole picture" of the credit cycle. Only by analyzing both together can management teams understand the impact of their credit approval standards and "preventable" debt associated with applicants that were not screened properly or that resulted from management "overrides" of the screening partner recommendation.

Services that offer both resident screening and multifamily collections can provide property owners and management teams with detailed reports matching the initial screening recommendation with actual bad debt. Also important to review is the length of residency and compliance with deposit recommendations versus actual deposits collected on the delinquent accounts.

These reports are the key to measuring the effectiveness of a management company's credit culture and how successful the screening partner is meeting their objectives. Without measurement of the screening process as part of the "whole picture" credit cycle, the true results may be diluted.

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