Be Cautious When Your Applicant Has a Recent Foreclosure
by Kevin Cleveland

With home foreclosure rates still at an all-time high, especially in Arizona and California, many multi-family property owners are tempted by the prospect of an influx of renters.

While "the more the merrier" works in a lot of industries, the apartment industry is not one of them. The surest way to risk net operating income (NOI) levels is to overlook these higher-risk renters by relaxing your screening methods and minimizing foreclosures.

Property owners and managers who rent to those with a recent foreclosure are likely to increase their financial risk affecting their bottom line if they view all foreclosures as the same. Most likely, the financial woes of these former homeowners will follow them from their houses to their rental units, increasing the risk for the property owner.

Because houses are most people's greatest asset, owners in even the deepest economic trouble will typically continue to pay their mortgage while they let other bills slide. So when they lose their home, there is a good chance they still owe money on their car, student loan or credit cards. As they accrue interest and late fees, these debts will almost inevitably prevent this population from being good renters.

Long-Term Strategy Works Best
Property owners may be tempted to overlook the financial hardships of this new and growing applicant pool in an effort to raise physical occupancy. This may lead them to soften the criteria for renters, or worse, minimize foreclosures.

Property owners who rely on a rule-of-thump method of applicant screening can let their sympathy for the people who lost their homes cause them to relax their screening process. Because the rule-of-thumb method is subjective and easy to manipulate, owners can simply minimize or eliminate the weight of recent foreclosures during the screening process in their quest for occupancy.

This approach is more than financially risky – it may be legally questionable. The Fair Housing Act requires that no group be singled out for either discrimination or special treatment.

When recent foreclosures are overlooked, it gives that group of applicants an unfair advantage over everyone else. Fair housing lawsuits are not trivial; the U.S. Department of Justice has assessed fines of hundreds of thousands of dollars for violations.

Instead, property owners should focus on a long-term strategy to increase NOI through attraction and retention of residents that meet their rental obligations and renter credit quality goals.

Reliable, Statistically-Validated Screening
Rather than manually adjusting scores, eliminating variables or relying on intuition, owners and managers can use tools based on historically predictive variables to evaluate applicants. A scientifically-based tool is not only more accurate, it eliminates the emotional factors that can enter into the screening process, especially when it comes to rating someone else's financial hardships.

An objective, outcome-based statistical model also makes it possible to adjust scoring characteristics for the entire applicant pool in response to market dynamics, not intuition. As the market fluctuates, property owners can move scores down as unit inventories rise and move them up as the supply tightens. These types of adjustments increase renter credit quality and mad lower bad debts while staying in compliance with:

Fair Housing Regulation
Be smart. Screen every applicant. Although the foreclosure epidemic has turned former homeowners into potential renters, this is not time for property owners to look for a quick fix to fill vacancies or to be swayed by an applicant's plight. Foreclosures may be more common in 2009, but they are no less significant than five years ago when there were far fewer of them. Be sure to screen subprime applicants on the same basis as any other applicant.

Every leasing decision should be based on a scientifically-derived screening method, not adjusting criteria to ignore recent foreclosures. Doing so may impact your long-term financial goals by making exceptions to determined levels of risk tolerance. Such adjustments are a short-term solution that may have financial implications down the road.

Be smart and stay the course. When owners apply a statistically-validated scoring model to each rental application, their decision-making process remains sound and impartial. Risk is minimized, NOI is maximized and you are more likely to meet fair housing compliance.

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