



# Subprime *Sympathy*

With millions of Americans losing their homes, multifamily pros are welcoming once-and-future renters back to their markets. But some wonder if forgiving foreclosures in resident screening turns a blind eye to risk.

**L**ast September, an alarming trend began to emerge among rental applicants at Drucker & Falk, a third-party manager of 30,000 apartment units across the Sun Belt. One applicant in every 20 was coming into the leasing office bearing a credit record with a mortgage foreclosure. What was even more disconcerting was the likelihood that those numbers would increase—especially as national headlines touted the worst housing downturn in a generation.

Kellie Falk-Tillett, principal at Drucker & Falk, could see the writing on the wall as more consumers defaulted on loans for their homes. But she also knew that these applicants had likely rented before, and in that reality she saw an opportunity. In rental markets where competition was starting to pick up due to the “shadow market”—homeowners trying to rent out their house or condo before getting foreclosed on—these prospects were a ready-made segment to tap back into for her clients.

By Joe Bousquin

"These were our renters to begin with, and a lot of them just weren't ready to own a home," Falk-Tillett says. "We lost a lot of renters in the industry because of the no-income, no-money-down, no-interest loans that let them go and buy homes they couldn't afford. They were always our renters. Now we're just getting them back."

Falk-Tillett is definitely onto something. RealtyTrac, an Irvine, Calif.-based real estate research firm, recorded 2.2 million foreclosure filings nationally in 2007, a 75 percent increase from 2006. The firm said more than 1 percent of all U.S. households were in some stage of foreclosure during 2007, nearly doubling the number that faced the possibility of losing their home in 2006.

Indeed, across the multifamily industry, owners and managers say the foreclosure trend is real; they're increasingly seeing prospects coming back to them who have lost their homes, or who will shortly. Many voice sympathy for the situation these once-and-future renters face

multifamily operators can easily isolate and look past foreclosures. But some apartment vets also question the wisdom of using the technology to do so, especially in an industry where limiting exposure to the risk of uncollected rents is only second to keeping occupancy rates at profitable levels.

#### OPTING OUT

At Drucker & Falk, company executives realized that in order to recover those renters, they had to modify their internal systems. Basically, the prospects had to gain approval through ResidentCheck, the resident screening system the firm uses to vet income, financial, and criminal background data among its applicant pool. Traditionally, those systems have viewed foreclosures in an applicant's credit history as grounds for automatic denial. With a rising number of individuals facing foreclosures in today's market, Falk-Tillett asked Dallas-based ResidentCheck if it could isolate foreclosure data among lease applicants and still

Neither does Camden Property Trust, the Houston-based REIT that counts more than 62,000 units in its national portfolio. In fact, the firm is now proactively identifying prospects who are getting squeezed by the mortgage crunch. "We are actively marketing to individuals who are in pre-foreclosure," says Kristy Simonette, vice president of business services at Camden, who notes that the firm subscribes to an information service that provides foreclosure data on mortgage holders in various markets.

Working with LeasingDesk, the resident screening unit of Carrollton, Texas-based multifamily software firm RealPage, Simonette adjusted Camden's screening criteria to allow for applicants with foreclosures in their histories, so long as other financial benchmarks were still intact. "If they are still credit-worthy, aside from having a foreclosure, we want them back as our residents," Simonette says.

And at Jupiter Communities, a Chicago-based owner and manager of approximately 11,000 units in 11 states, Shridhar Shah, vice president of finance, says the company started working with its resident screening provider, Richardson, Texas-based Resident Data, to exclude foreclosures from its screening criteria when the number of applicants with foreclosures began to balloon last December. In just two months, the firm went from what Shah describes as "a handful" of prospects to 163 would-be residents who had past foreclosures or were facing the imminent loss of their homes.

#### RISKY BUSINESS?

But there are those who don't see the trend as an opportunity. In fact, their outlook is much more cautionary. "The prospect that multifamily owners are about to shoot themselves in the foot is very real," says Nevel DeHart, executive vice president at First Advantage SafeRent, a rent screening agency that is advising clients to stick to traditional criteria in the face of the subprime meltdown. "You've used resident screening in the past on foreclosure issues; use it now for the same reason. These things have not changed."

Indeed, not all multifamily operators view applicants with foreclosures as desirable today. "We absolutely do not want to create any type of an exclusion-

## Screening Scruples

Use these guidelines to establish a wise screening strategy for rental applicants with foreclosures in their histories.

- **Identify the market opportunity.** Prospects with foreclosures are entering back into the market. Decide as a firm whether that is a potential renter segment you want to pursue, and adjust your screening criteria appropriately.
- **Stay stringent.** Don't use lowering of your foreclosure standards as an excuse to let just anybody through your doors. Though individuals who managed to protect their credit aside

from a foreclosure may be desirable, many applicants may have destroyed their credit by trying to save their dream home.

- **Protect thyself.** If you decide to let in renters with foreclosure histories, limit your risk by requiring larger deposits or stagger your lease terms. If you implement this policy across the board with your screening criteria, you will avoid any Fair Housing issues.

today. But they also see a market opportunity—and, in many cases, an obligation—around supplying for-rent housing to individuals who have lost the homes that they gained through subprime mortgages and the unchecked excesses of the real estate bubble.

That national trend comes at the exact moment when resident screening technology has evolved to a point where

consider them for approval if the rest of their credit was intact.

"We changed our screening criteria so that those people would still have opportunities to lease an apartment," Falk-Tillett says. "Now, even if they have a foreclosure, we can look at the rest of their credit, too. If they're still paying their other bills, we don't hold the foreclosure against them."

## Two Sides of a Coin

The industry is undecided on whether it should accept residents with foreclosures on their credit records. Two insiders sound off.

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ary screening model that would say, ‘OK, if you have a foreclosure, we don’t care, we’ll just score you on everything else,’ says Scott Youngman, credit and collections manager at Home Properties, the Rochester, N.Y.-based REIT that owns almost 37,000 units in the Eastern United States and is a First Advantage SafeRent client. “The level of risk a property management company deems acceptable is their own business decision, but we believe if you allow those individuals in, ultimately you are going to increase your bad debt.”

The division within the industry of whether applicants with foreclosures are desirable can largely be drawn along the lines of which type of screening technology a company uses. On the one hand, systems such as ResidentCheck, ResidentData, and LeasingDesk are built on a “rules-based” architecture, where multifamily operators can decide which criteria should be included on a given screen at a given time. Proponents say that allows for flexibility, while critics contend that it allows managers to change the rules as they go. Conversely, a second option is to use a statistical model that looks at which factors are statistically relevant for predicting future behavior. That’s the underlying structure of First Advantage SafeRent’s system. Advocates for statistical modeling say statistics don’t lie, while naysayers contend it unfairly lumps individuals, such as those who were sold a bum mortgage, into one “bad” group.

DeHart says that fair or not, the fact is that foreclosures are rarely stand-alone financial events. “If you look at people who lose their homes, they’ve extended

themselves in almost every other area of credit as well, because the last thing they want to do is give up the castle,” DeHart says. “The risk of renting to someone who’s been foreclosed on is that you don’t know who else is pounding on their door. Statistically, they’ve got train-wreck credit.”

### NO CARTE BLANCHE

Indeed, even proponents of rules-based screening systems concede that the flexibility the systems offer needs to be used judiciously. “There comes a point when you have to ask yourself if you’re being like Ben Bernanke and letting everybody off the hook,” says Pam Storm, vice president and general manager of Resident Data. “Yet, at the same time, in this market, it’s extremely important to be adaptable. We try to provide our clients that ability, while giving them data that helps them make the decisions they need to make.”

In other words, just as foreclosures rarely happen as unique events, forgiving them in your applicants’ financial history shouldn’t open the door to lowering all your screening standards to sidewalk level. For instance, Storm points out that even if clients choose to opt out of foreclosure screening, they can still run their applicants through her firm’s proprietary database of habitual rent skippers or limit their financial exposure in other ways. “What we’re seeing now is more people changing their overrides to say, if they do have a foreclosure, then maybe we should increase the security deposit,” Storm says. At Camden, Simonette says the company is doing just that.

Whatever side of the issue multifamily companies come down on, though, one trend is clear: The issue of applicants with foreclosures in their histories is only going to become more widespread, not less. They’re so prevalent, in fact, that some see the situation as a call to arms for multifamily owners. “There’s so many people being foreclosed on right now that their only alternative for housing is to rent,” says Jupiter’s Shah. “The industry has to take that into consideration.” [M]

*Joe Bousquin is a Sacramento, Calif.-based freelance journalist.*

