Risk versus reward

Identifying the highest-quality resident
using rental payment history

Experian RentBureau

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About the analysis

Identifying the highest-quality resident at the point of application who will pay rent on time every month is challenging. Failing to do so has significant financial repercussions, including lost revenue, increased vacancy, bad debt and a potentially lengthy collections process, all of which negatively impact net operating income (NOI) and profitability. Considering the risk, it is imperative that property managers and owners leverage the most comprehensive information available when screening an applicant.

In *Risk versus reward: identifying the highest-quality resident using rental payment history*, Experian® RentBureau® analyzed data from a subset of the larger Experian RentBureau database comprised of rental payment history on more than 10 million residents nationwide. The analysis examines the risk posed by renters and the most effective screening metrics to employ in order to avoid lost revenues from risky residents.

In this analysis, Experian RentBureau reveals the renter risk profile and the resulting impact to NOI among 200 property managers and owners across 12,000 Class A and Class B properties. The analysis explores default rates, credit scores and resident age demographics for nearly 755,000 residents who initiated leases between March 2006 and December 2012.

In order to make the most informed screening decision possible, property managers and owners must choose from a myriad of screening providers as well as various data sources and analytical strategies. Included in the analysis is an examination of the use of rental payment data and credit report information in the screening process and the resulting effectiveness in delivering an accurate prediction of an applicant's likelihood to default on his or her rental lease. Credit report data includes information on past payment behavior on an applicant's credit obligations, such as credit cards, auto loans and mortgages.[1]

Only recently made available to the multifamily industry for use in screening, rental payment data is an increasingly critical solution. This data includes on-time payments, nonsufficient funds (NSF), write-offs and rental collections and provides unique, industry-specific and powerful insights. The following analysis investigates this data and, in particular, the use of rental payment data in conjunction with credit scores in the screening process to produce a superior prediction of a resident's propensity to default.

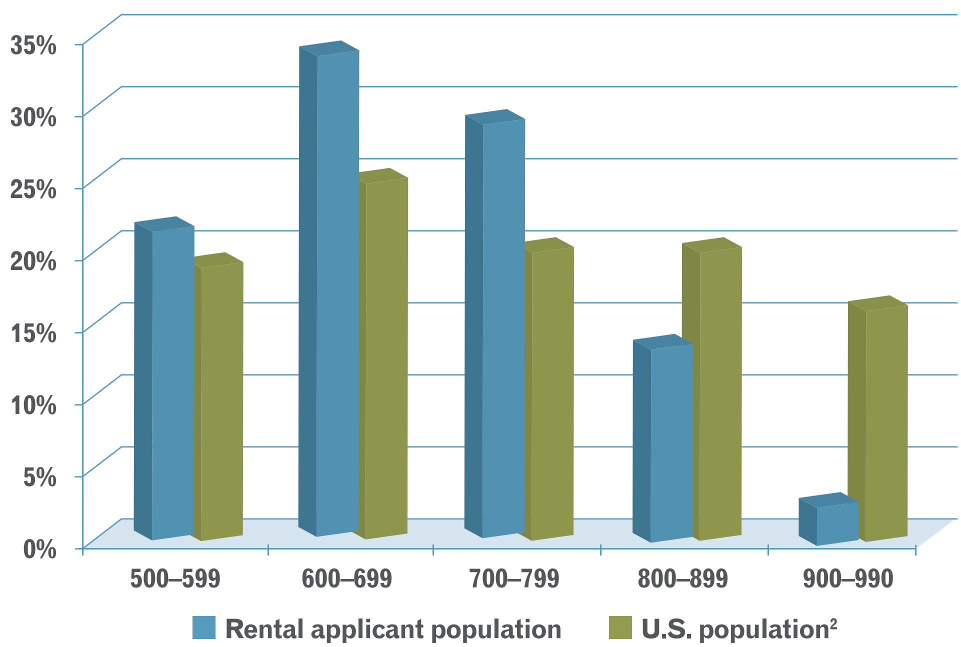
[1]*For the purpose of this data analysis, Experian RentBureau utilized the VantageScore® advanced credit scoring model, which produces a highly predictive score and scores up to 14 million more consumers previously deemed unscoreable. VantageScore has a scale range of 501 to 990 to represent a consumer's creditworthiness.*

Risk versus reward

Today's renter: a risk profile

When compared with the distribution of credit scores in the U.S. population, multifamily residents tend to have lower credit scores and consequently represent a higher risk group overall. As the analysis revealed, 85 percent of the rental applicant population is in one of the three lowest VantageScore® credit ranges (501 to 799), compared with a national average of only 64 percent. The largest variation by credit rating range is for rental applicants in the 900-plus VantageScore range, which has 14 percent less than the national norm.

Distribution of VantageScore for the rental applicant population

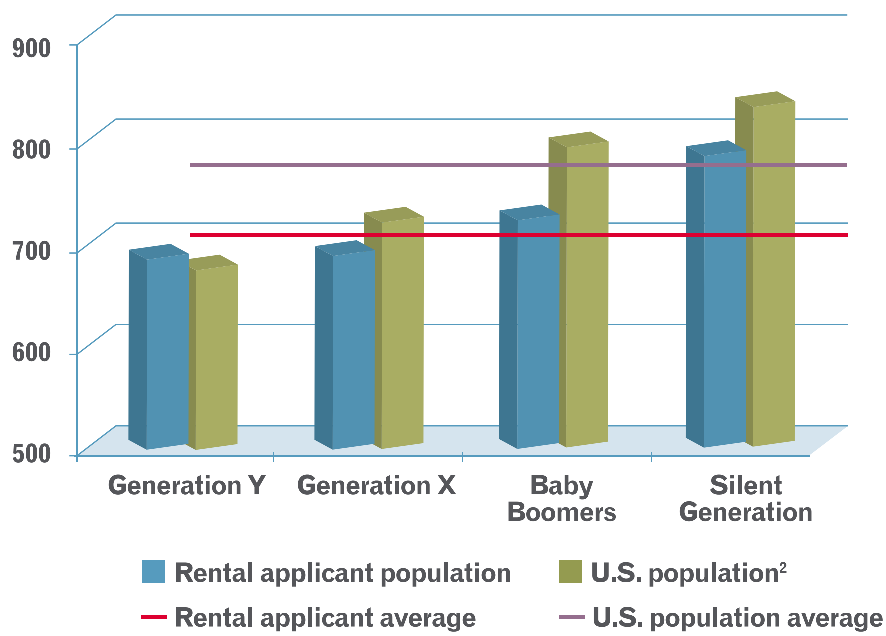


Renters also are much more likely to be members of younger generations. More than half (51.46 percent) of applicants in the sample set belong to the Generation Y demographic (ages 18 to 29), which represents a critical audience in the current rental market. Another 30.29 percent of individuals belong to Generation X (ages 30 to 45), 14.61 percent are Baby Boomers (ages 46 to 64), and only 3.64 percent are in the so-called Silent Generation over age 65.

[2]*Source: U.S. population http://www.experian.com/live-credit-smart/vantage-score.html.*

Further defined by age demographic and VantageScore, renters in the study generally exhibited notable differences in average VantageScore compared with the corresponding age demographic in the overall U.S. population. The score difference was greatest for the Silent Generation, which had a VantageScore of 759, compared with a national average of 782. However, the difference was more muted for younger renters, with Generation Y renters showing slightly higher credit scores than the Generation Y individuals overall with a 678 data set average VantageScore versus a 672 U.S. average. The closer alignment with respect to VantageScore for Generation Y renters and the overall U.S. population is not surprising, as many of the individuals in this age group are indeed renters.

Average VantageScore by rental applicant age demographic



The resulting risk and NOI impact to property managers and owners

Further insight into the risk profile of a renter is the overall lease default rate exhibited by renters in the sample set studied in this analysis. In Experian RentBureau's examination of 755,000 residents, more than 55,000 were identified as bad (indicating a lease was terminated with a write-off, debt collection or outstanding balance), resulting in an overall default rate of 7.33 percent. In terms of a dollar amount, Experian RentBureau's recent analysis of lease default reveals an average write-off or collection of more than $2,000 per default.

[2]*Source: U.S. population http://www.experian.com/live-credit-smart/vantage-score.html.*

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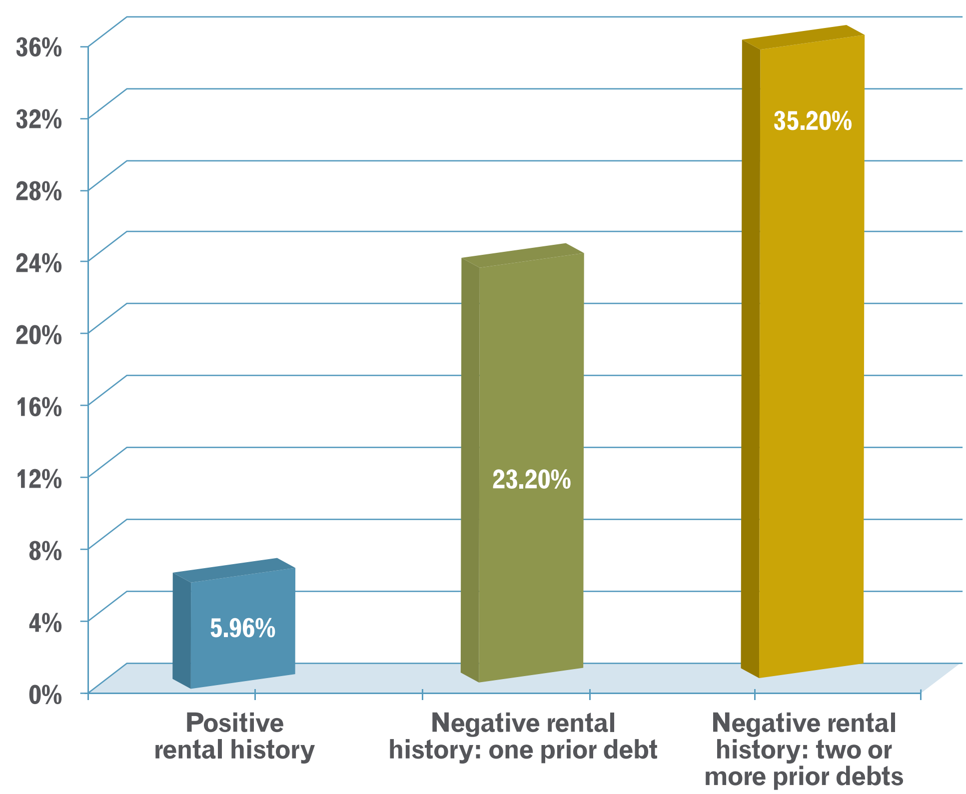
For property managers and owners, the opportunity to gain a significant NOI increase from even incremental improvements in lease default rates is compelling. Once magnified over hundreds of thousands of residents, the collective impact to NOI of a write-off or collection amount of more than $2,000 per default gains particular significance. It thus remains critical for multifamily managers and owners to understand that the universe of American renters is comprised of consumers with lower credit scores and a higher risk profile. Property managers and owners seeking to mitigate risk exposure and improve rent default rates consequently would be well-advised to use as many predictive data sets as possible when trying to identify an applicant's propensity to pay rent in full and on time.

How the past can improve the future: the predictive power of rental payment data

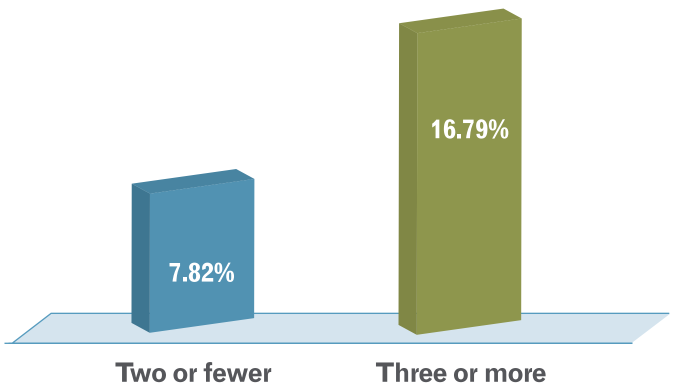
Not surprisingly, how an individual paid rent elsewhere is a good indicator of how he or she will pay rent in the future. Default rates for prospects with positive rental payment history (i.e., history unmarred by skips or unpaid balances) drop to 5.96 percent, while default rates for prospects with one prior rental debt skyrocket to 23.20 percent. The population of renters who have two or more prior rental debts and are likely serial skippers have a default rate that is even higher at 35.20 percent — nearly six times higher than among applicants with positive rental history.

Default rates by rental payment history



Likewise, default among residents who have a history of late or NSF payments escalates steadily as the number of late and NSF payments increase. Applicants with two or fewer recorded late or NSF payments show a slightly above-average default rate of 7.82 percent, while applicants with three or more late or NSF payments show a default rate surging up to 16.79 percent.

Default rates by frequency of late and NSF payments



Rental payment data gives unprecedented insight into a prospective resident's likelihood to pay rent. With this detailed information, on-site teams are able to make better leasing decisions by identifying risky residents and accepting more high-quality residents at the point of application.

A powerful combination: leveraging rental payment data and credit scores in screening

The traditional approach to mitigating lease default and corresponding income loss is to screen rental prospects based on credit. A person's credit score, as measured in this study by VantageScore, is an effective input for screening as it is highly predictive of rental default. In fact, rental applicants with the highest credit scores show much lower rates of default compared with applicants with lower credit or without credit.

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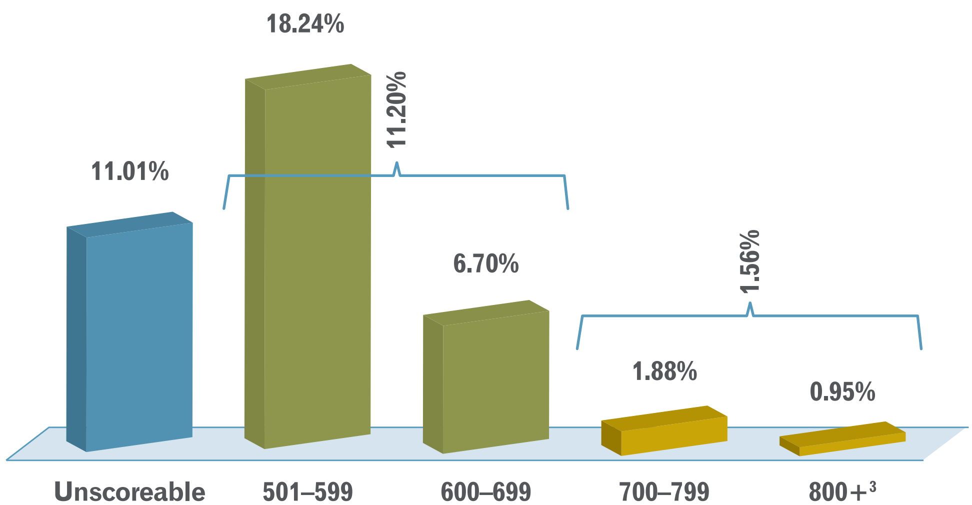
For example, rental applicants in the Experian RentBureau data analysis with a VantageScore of 700 or greater had a default rate of only 1.56 percent, compared with default rates of 11.20 percent among applicants with a VantageScore between 501 and 699 and 11.01 percent for applicants who could not be scored for credit (unscoreable applicants therefore exhibited a default rate more than seven times greater than high VantageScore applicants).

Applicant default rate by VantageScore



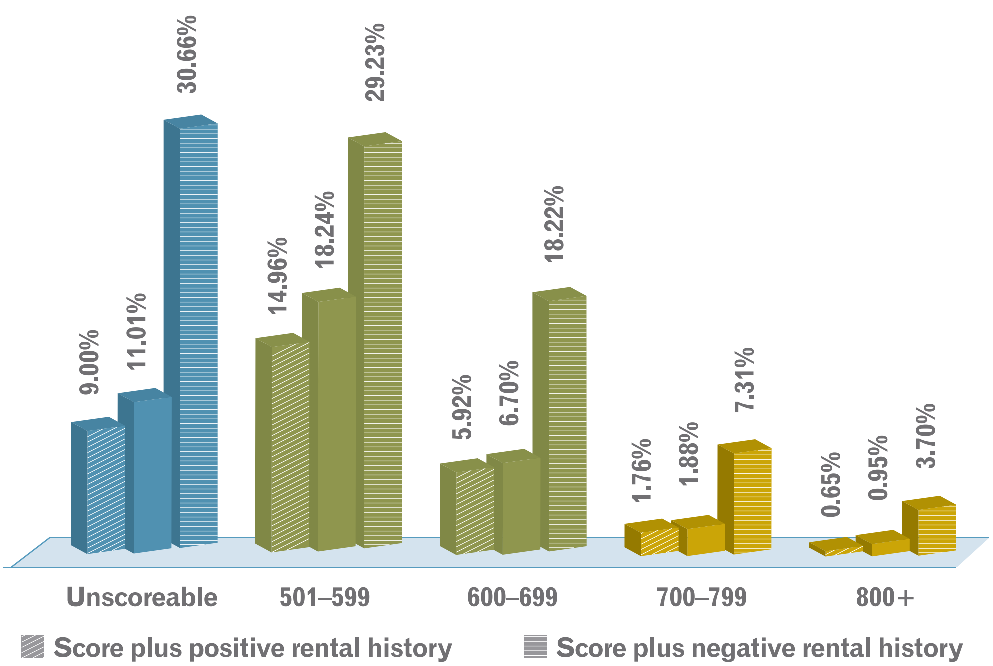
Default rates among lower and no credit score applicants thus make lease qualification by credit score an effective screening approach. Yet, for many property managers and owners, simply approving only high credit score applicants and rejecting prospects with lower or no credit scores is unrealistic in practice given occupancy requirements and local resident demographics. In addition, regardless of credit score result, incorporating rental payment data in combination with an applicant's credit score in screening provides a more comprehensive understanding of an applicant's risk profile and, specifically, his or her likelihood to pay rent as agreed.

[3]Ranges 800-899 and 900-990 were combined due to samples of records with negative rental history in the 900+ range.

Identify hidden risks to protect NOI

To improve rent default rates and better assess an applicant's risk, property managers and owners are best served by utilizing rental payment data in conjunction with credit scores. Although highly predictive overall, in certain cases a high credit score does not correspond with likelihood to pay rent in full and on time, nor does a lower credit score always equate to propensity to default. Additionally, the need to leverage the combination of rental payment data and credit scores in screening is further magnified by the 64 million thin-file and no credit file consumers in the United States.

Applicant default rate by VantageScore and rental history



As shown by the sample set of this analysis, rental payment data can be used to further differentiate between higher- and lower-risk applicants, even for applicants within the same credit score range. For example, residents with positive rental payment data and credit scores ranging from 500 to 599 exhibited nearly half the default rate (14.96 percent) of residents within the same score range with negative rental payment history (29.23 percent). Additionally, applicants with high credit scores between 700 and 799 who also had negative rental payment data were more than four times as likely to default (7.31 percent) as those with positive rental data (1.76 percent), further underscoring the need to leverage both rental payment data and credit data in screening.

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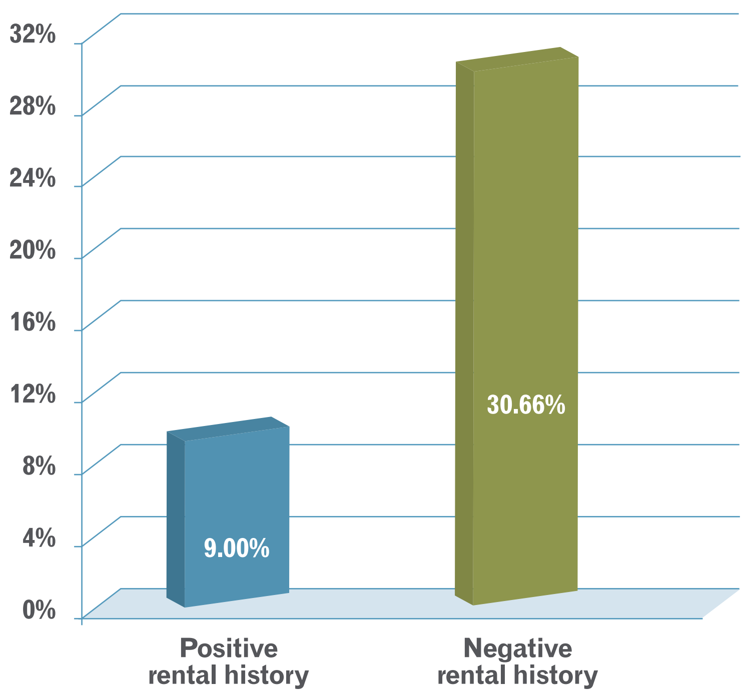
Improve occupancy by using rental payment data to qualify credit unscoreable applicants

Rental payment history data provides one of its most tangible applications when used to qualify prospects without a credit score due to thin or no credit history. In the Experian RentBureau analysis, 10.01 percent of individuals did not have enough credit history available at the time of screening to receive a VantageScore. Traditionally, in the absence of a credit score, only limited information regarding the overall payment practices of this subset of applicants is available, therefore necessitating that property managers and owners reject potentially on-time and in-full paying residents or set additional conditions for approval.

Unscoreable applicant default rate by rental history data



For multifamily managers and owners seeking to improve occupancy while also managing risk, augmenting the lack of a credit score with rental history data shows immediate payback. Those with positive rental history had a default rate of 9 percent, lower than the overall average for the unscoreable applicants in the study (11.01 percent), and could make strong renters for managers looking to expand their occupancy. In contrast, unscoreable leases with negative rental history data showed an associated default rate of 30.66 percent, and managers incorporating rental data in their screening process could likely avoid such losses.

Build resident credit history to encourage retention and renewals

In addition to leveraging the data in screening, property managers and owners also benefit by furnishing rental payment data to Experian RentBureau. Furnishing rental payment history data provides property owners and managers with the opportunity to help residents establish or build their credit history, which particularly helps those individuals without prior credit histories. As Experian is the only major credit reporting agency to incorporate positive multifamily rental payment data into consumer credit reports, property managers and owners have the opportunity to offer a tangible, built-in amenity that encourages resident retention and renewals. Additionally, by reporting skips and write-offs, managers can prevent skippers from getting another lease until they have been repaid, generating recoveries without the need to utilize a collections agency.

Conclusion

The data presented in this analysis demonstrates that within the universe of renters there are many potential risks to the multifamily property manager and owner. In the analysis, 7.33 percent of renters in Class A and Class B properties end their lease owing money, therefore creating thousands of dollars in write-offs or collections and ultimately affecting the property's NOI. In addition, the average renter is younger and more risky in terms of credit score compared with the overall U.S. population.

However, opportunities exist for managers to more effectively screen applicants by utilizing rental payment data in combination with traditional screening criteria such as credit reports and scores. By identifying individuals with negative prior rental payments, managers can avoid renting to individuals who show a 25 percent chance of defaulting again.

Additionally, positive rental payment data can be used to confidently approve applicants who either don't have credit scores or have credit scores below acceptable thresholds. Such approvals can increase occupancy rates without further increasing losses.

The impact of rental payment data in screening is strongest when used in conjunction with credit scores. By turning down applicants who would have been approved by traditional screening criteria but who show a history of not abiding by their rental lease agreements, property managers and owners in this study could have significantly reduced their overall losses, therefore making a direct impact to NOI.

Finally, including reporting of rental payment history to the Experian credit file gives multifamily property owners and operators the opportunity to help residents build their credit history by paying their rent as agreed.

The multifamily apartment industry stands to recover millions of dollars in write-off losses, improve resident qualifications by identifying low default risk applicants, decrease costly skips, and offer residents a value-added amenity through the adoption and application of rental payment history.

About Experian RentBureau

Experian RentBureau is the largest and most widely used credit reporting agency for the multifamily industry. Experian RentBureau's database receives rental payment histories every 24 hours from property management companies and electronic rent payment processors and currently includes more than 10 million residents nationwide. Data contributors report their rental data to Experian RentBureau directly and automatically. Property management companies utilize this data to screen new rental applicants' payment history as part of their existing resident screening services.

To learn more about Experian RentBureau, visit www.rentbureau.com.

About Experian

Experian is the leading global information services company, providing data and analytical tools to clients around the world. The Group helps businesses to manage credit risk, prevent fraud, target marketing offers and automate decision making. Experian also helps individuals to check their credit report and credit score, and protect against identity theft.

Experian plc is listed on the London Stock Exchange (EXPN) and is a constituent of the FTSE 100 index. Total revenue for the year ended March 31, 2013, was US $4.7 billion. Experian employs approximately 17,000 people in 40 countries and has its corporate headquarters in Dublin, Ireland, with operational headquarters in Nottingham, UK; California, US; and São Paulo, Brazil.

For more information, visit www.experianplc.com.

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06/13 • 1224/2849 • 6779-CS