Should You Consider Foreclosed Applicants?

by Mike Lapsley
RentGrow, Inc.

The foreclosure crisis continues to dominate headlines, and the outlook remains grim. According to RealtyTrac, 2008 saw 3.2 million foreclosure filings on more than 2.3 million properties. This represents an increase of 81% in total properties from 2007 and 225% from 2006.

So when it comes to applicant screening, how should you handle applicants who are coming to you from a foreclosure? Should this raise a red flag? Should you consider accepting applicants with a foreclosure? Are these applicants "risky" or merely victims of a mortgage industry run amok? The best answer seems to be "it depends," and it pays to take other factors into consideration when weighing your options.

With the growing number of foreclosures that we hear about every day, many rental properties are seeing an increased volume of foreclosures in their applicant pools. Still the actual volume remains quite small – just around 2% based on our most current data. Compare that number to the percentage of applicants who have medical collections – consistently over 30% – and you begin to realize how small it really is in the grand scheme of things.

You may be experiencing a higher rate in your market and we understand the concerns surrounding those foreclosed applicants who do cross your desks. The decision about whether to accept these applicants will depend on your management company's philosophy, geography, and market concerns (e.g. how tight is the market and how high are occupancy rates?). As you make this decision, here are some issues to consider as well as some strategies for minimizing risk if you do decide to accept foreclosured applicants:

A Foreclosed Applicant May be a Good Renter.
During the last several years many people made poor home-buying decisions by getting into unrealistic mortgage programs. Some individuals in these situations may still be worth considering. In other words, there are times when a foreclosure is not necessarily indicative as to whether someone is a responsible resident who can make rental payments on time.

Adopt Simple Changes to Your Screening Criteria.
If you do decide to consider foreclosure applicants, you can change the criteria in your screening process to help you make a more informed decision about those applicants. Some resident screening systems even give you the option to remove foreclosures from scoring. In these cases, we recommend that you consider the following: Is the rental payment going to be lower than the mortgage payment? and Does the applicant's credit score improve—or does she or he "pass"—when you take the foreclosure out of the equation during the credit check?

If the answer to these questions is yes, it's possible that you could have an acceptable applicant despite the foreclosure. But before you can make that decision, it's important to get a more complete overview of their credit history.

Don't Overlook Collateral Damage.
Whether it's by necessity or by choice, individuals who have gone through a foreclosure often allow other financial commitments, like auto loan payments, to slip –this is what we refer to as "collateral damage." Trying to separate out collateral damage that's related to the foreclosure as opposed to just plain bad credit can be risky. That's why we recommend that if an applicant doesn't meet your resident screening criteria after you've removed a foreclosure, it's best not to overlook any additional problems. The fact is, you'll never know for sure whether those problems are related to the foreclosure or whether they are cause for ongoing concern.

In our experience, most companies today are in fact considering applicants with foreclosures, and while this seems to be the current trend, we also realize the importance of identifying ways to mitigate the risk. With the strategies we've outlined above, we believe you can make informed decisions about foreclosured applicants. ■

Mike Lapsley is president and CEO of RentGrow, Inc., the resident screening experts (www.rentgrow.com). He can be reached at lapsley@rentgrow.com.