Tenant risk: 5 metrics to consider

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According to the results from the annual PayProp State of the Rental Industry survey, over 50% of participants said finding good tenants in the current market is their biggest challenge.

Image source: www.pexels.com

"In the coming months, it will be even more important for rental agents to be able to distinguish a low-risk tenant from a high-risk one, thereby better serving the needs of their customers," says PayProp head of data analytics Johette Smuts.

In a recent follow-up report, the quarterly *PayProp Rental Index for Q1 2021*, the company uses credit metrics to identify and analyse different tenant risk levels to further help agents be more informed when choosing prospective tenants. As Smuts says, "In a market where everyone is struggling to find good tenants, it pays to know what to look for!"

Smuts says that minimum-risk tenants represented almost 40% of the credit checks done through PayProp in Q1 2021 – slightly higher even than in Q1 2020. More than 60% of tenants fall into the combined minimum- and low-risk categories, while only a quarter were labelled as high-risk. "While this seems counterintuitive, it could be that high-risk tenants fall out of the vetting process even before a credit check is done."

Q1 2021 sees uptick in residential rental sector

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1. Income

Smuts explains that minimum-risk tenants tend to have higher incomes than those in other categories, and by quite a margin. "In Q1, this group had an average monthly net income of close to R42,000 – almost R8,000 higher than low-risk tenants, and more than R15,000 more than high-risk tenants.

2. CPA and NLR accounts

Tenants across all risk categories have between 9 and 11 Credit Provider Association (CPA) accounts and National Loan Register (NLR) accounts.

Smuts says there is a fundamental difference between the two, with CPA accounts regarded as ‘good’ debt and NLR credit as ‘bad’ debt on credit checks. “You can expect a prospective tenant to have several CPA accounts, including things like insurance, mobile phone contracts, retail stores and vehicle finance,” she says.

“NLR accounts, on the other hand, are the ones you don’t want to see on a credit check. These include short-term loans from micro-lenders, usually with very high interest rates. A higher number of bad debt accounts can be indicative of a prospective tenant having needed additional funds to make it through the month or not qualifying for credit from other providers, both of which are warning signs.”

3. Major delinquencies

Unsurprisingly, high-risk tenants had more major delinquencies against them than other groups, at 41% of the tenant survey base compared to 25% of medium-risk tenants. A major delinquency can include various types of negative entries on an applicant’s credit record, such as judgements, notices, adverse accounts, etc. Less than 1% of minimum-risk tenants had a major delinquency against their name.

4. Debt

Riskier tenants tend to have a higher debt-to-income ratio than lower-risk ones, meaning they spend a higher percentage of their monthly income on debt repayments each month.

High-risk tenants both have a higher debt-to-income ratio (on average 47% in Q1) and spend smaller amounts on their debt repayments. The average high-risk tenant spent just over R12,500 a month on debt and other financial obligations, compared to minimum risk tenants, who spent almost R15,000 a month on repaying a lower average debt burden faster (25% of their income).

5. Credit score

Since tenants are placed into risk categories based on their credit score, minimum-risk tenants have higher (better) average credit scores than higher-risk tenants. The difference between the two is almost 100 points (690 vs 592).

Smuts says that in this time of economic difficulty, exacerbated by Covid-19 and tenants exiting the market, agents are well advised to have robust tenant selection partnerships in place.