(BN) Plastic-Shy U.S. Young Spur Move to New Credit Data: Econom y (1)

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(Adds homebuilder index, markets in seventh, eighth paragraphs)

By Jeanna Smialek

March 18 (Bloomberg) -- Charlie Frohne never wanted a Visa or MasterCard, afraid of incurring debts he couldn't repay. As the 30-year-old searched for a Manhattan apartment, he found landlords treated his lack of a credit history as a liability.

His experience highlights a growing reluctance among young adults to use plastic for everyday purchases. Thirty-nine percent of undergraduate students between the ages of 18 and 24 owned a credit card in 2012, down from 49 percent in 2010, a Sallie Mae and Ipsos Public Affairs survey found. And young adults who do have credit cards are carrying smaller balances: A median of $1,600 in 2010 compared with $2,500 in 2001 for under-35 households, according to Federal Reserve data.

The trend, rooted in stricter lending rules and weaker job outlooks for young Americans since the 2008-2009 recession, has implications for the strength of the economy. As people in Frohne's age group eschew plastic, fewer are building the credit histories that would help them to gain financing for purchases of homes and cars that are critical to economic growth.

"You could say that they're not going to get mortgages, and that could have dire economic consequences," said Ann Schnare, who is now a consultant in the mortgage industry and who formerly worked as vice president of housing economics and financial research at Freddie Mac in McLean, Virginia. "But that assumes a static model. I think that the industry will respond."

Credit bureaus and the lending industry are stepping up their search for new ways to bolster credit files, and young people who don't pay credit card bills often do pay mobile phone bills. As reporting agencies gather data from telephone, rent and other payments, some scoring models incorporate it to help assess candidates' creditworthiness.

Circular Credit

"If the only way to get credit is to borrow, young people are going to be slower to borrow. It is circular," said Rachel Schneider, senior vice president of insights and analytics at the Center for Financial Services Innovation, which grew out of a research project done on behalf of the Ford Foundation in 2002 and strives to help so-called "underbanked" consumers access stable financing. Leveraging extra data is a way of "bringing new people in" for banks as the economy rebounds, she said.
"It helps them expand the market."

Homebuilder Confidence

In a sign that the recovery will take time to strengthen, a gauge of confidence among U.S. homebuilders unexpectedly fell for a second month in March. The National Association of Home Builders/Wells Fargo index of builder confidence dropped by 2 points to 44 this month, due to a decrease in the measure of current sales, a report from the Washington-based group showed today.

U.S. stocks fell, after the Dow Jones Industrial Average reached record highs last week, as a levy imposed by euro-area leaders on deposits in Cyprus's banks sparked concern the region's debt crisis is intensifying. The Standard & Poor's 500 Index dropped 0.5 percent to 1,552.73 as of 10:32 a.m. in New York.

Credit card borrowing, one of the drivers of the consumer spending that makes up 70 percent of the U.S. economy, has been shrinking across all age groups since the recession. New York Federal Reserve data showed that total credit card debt declined by $25 billion, or 3.6 percent, for the fourth quarter of 2012 from the same period in 2011. Since the fourth quarter 2007, it has dropped about 19 percent, based on Fed data.

Younger Consumers

The decrease has been marked among consumers younger than 35, a Pew Research analysis released last month found. Credit card use for young people began declining prior to the recession, and between 2007 and 2010 dropped 20 percent, based on the Pew findings. The share of young American households carrying a credit card balance fell to 39 percent in 2010 from 48 percent in 2007.

That could be partly the result of a 2009 law, the Credit Card Accountability Responsibility and Disclosure Act, which made it more difficult for credit card companies to market and distribute cards on college campuses, said Brannan Johnston, vice president and managing director of credit bureau Experian Plc.'s RentBureau division.

Scarce job opportunities for young adults also play a role. Unemployment for those between the ages of 20 to 24 stood at 13.1 percent in February, up from 7.4 percent in February 2007. Joblessness rose to 7.8 percent among 25 to 34 year olds from 4.8 percent in 2007, based on Labor Department data.

Job Prospects

"There's a greater awareness among young people about the risks of borrowing when job prospects are lower," said Terry Sheehan, an analyst with Stone and McCarthy Research in Princeton, New Jersey.

The U.S. unemployment rate fell in February to 7.7 percent, its lowest level since 2008, according to Labor Department data.

Regardless of the cause, a generation of credit-averse consumers could weigh on the economic recovery.

"Given the trends in credit usage by younger Americans, I think there will be a growing number of Americans who are credit-invisible," said Michael Turner, chief executive officer of the Policy and Economic Research Council, a Durham, North Carolina-based non-profit that researches ways to extend credit to those who lack it.

Without histories to inform them, lenders may shy away from young consumers and landlords may deny leases or charge higher security fees, Schnare said.

Thin File

"You don't have a credit history and they consider that a bad thing," said Frohne. While no landlords who turned him away cited his thin credit file, Frohne said several "seemed to frown on it. It's always a bump in the road."

Now, the recovering economy has rekindled interest in capturing previously unreported data to allow credit bureaus and lenders to create more complete consumer credit profiles, even for those who don't borrow.

“There will definitely be more economic activity,” Turner said. “Those same people who aren’t using credit cards or auto loans or mortgage loans are paying cable or broadband.” Data on energy and telecommunications payments can make good gauges of creditworthiness and could allow banks to extend more, safer loans, according to a December 2006 Brookings Institution report by Turner, Schnare and three other researchers.

It’s unclear what information can be turned over and collected under the Fair Credit Reporting Act, Turner said.

Beyond that, data such as rental payment histories is tough to collect, because it requires the cooperation of large numbers of billers.

Experian Partnership

In an effort to overcome that difficulty, Dublin-based Experian in 2010 acquired RentBureau, which collects rental payment data in the U.S. A partnership announced last month will let renters pay through Northbrook, Illinois-based WilliamPaid LLC’s online system and have positive payment data added to Experian credit files.

While RentBureau has relationships with large property managers, the new partnership will allow the company to access more data from renters with smaller landlords, RentBureau’s Johnston said.

Without such systems for collecting credit information, “not only is the individual not able to get credit from having a credit history, but we’re also not able to sell a report on them,” he said. “It’s in both the individuals’ interest and ours to try to expand the pie.”

Extra Data

The extra data collected by Experian and the other major bureaus, TransUnion Corp. and Equifax Inc., can be counted into credit scores using custom models at the companies. Much of it can also factor into VantageScore Solutions, a generic model introduced by the three companies in 2006.

Still, the practice of counting measures like utility payments into scores isn’t widespread. Minneapolis-based FICO’s standard credit scoring model remains the most widely used, and relies on traditional lines such as credit card and loan history.

FICO doesn’t use alternative data in its main model because it is “not consistently and broadly reported,” spokesman Anthony Sprauve said in an e-mail.

About 90 percent of credit scores purchased by lenders in the U.S. are FICO Scores, Sprauve said. While FICO builds custom scores that do incorporate alternative data, Sprauve said the traditional model accounts for most of that share.

Clay Selland, a certified public accountant who founded Signet Mortgage Corp. in 2003, uses traditional FICO Scores.

Still, he said he sometimes looks at factors outside of the traditional score to assess borrowers and help pair them with lenders.

Alternative Credit

“You can use the cable bill, and the cell phone bill and all that as alternative credit. It’s an uphill battle; it doesn’t open the client up to the full range of lenders,” he said.

Selland’s business, based in Danville, California, sees about 200 clients a year, about 10 percent to 15 percent of them seeking their first mortgage. While fewer than 10 percent have no file at all, he said, an increasing number are “thin-file” as the housing recovery pulls long-time renters into the home buying market -- and demand exists for more comprehensive gauges of their creditworthiness.

“I think the system is very difficult,” he said. It’s also hard on people who have credit wrecked by one or two financial missteps. “It leaves out a lot of high-quality folks.”

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