Bending Toward Justice:

Credit Scores as a Measure of CDFI Impact

FUND ci

FUND Community Institute

INTRODUCTION

Identifying and demonstrating CDFI impact has been elusive since the formal establishment of the industry in 1994. While it has often been hypothesized that a marker of CDFI success and impact would be for CDFI borrowers to "graduate" to working with traditional financial institutions, there has been little progress in supporting this and other claims. While such outcomes may be present across CDFI lending products, this research project focuses on the effects on credit scores of consumers accessing small dollar credit building loans (SDCBLs). Through this work, FUND Community Institute (FUND CI) and Credit Builders Alliance (CBA) reviewed data to test this claim, including credit score data collected from CDFIs as well as interviews with CDFI practitioners. The intent is for this work to be useful to CDFI practitioners in designing, administering, and tracking SDCBLs as well as to foundations and other funders of the industry in strategically targeting support.

The key findings of this study include:

- CDFIs almost universally find their SDCBL products extremely beneficial or beneficial to clients and others in the community.
- CDFIs report significant improvements in credit scores to SDCBL borrowers.
- There is anecdotal evidence that SDCBL borrowers go on to use mainstream financial services.
- While SDCBLs are generally not profitable, CDFIs plan to continue to offer them.

A NOTE ABOUT TERMINOLOGY

Small Dollar Credit Building Loan (SDCBL): The core purpose of this loan is to provide access to capital to address a variety of consumer needs, such as emergencies or unexpected expenses, cash flow interruption due to seasonal work, etc. The loan proceeds are released to the borrower immediately upon closing. These loans have credit building properties because the CDFIs report payments to credit bureaus.

Credit Builder Loan (CBL): The core purpose of this loan is to help borrowers build credit. It is structurally defined as being secured by the loan proceeds that are released to the borrower only upon repayment.

One of the findings of this report is that, in the CDFI industry, the term "Credit Builder Loan" is commonly used to refer to any type of small-dollar consumer loan for which the CDFI reports payments to credit bureaus. However, technically CBLs are a distinct type of SDCBL, which is therefore the more accurate umbrella term. This report includes data from CDFIs on all types of SDCBLs as the focus is on the effects of the credit building activities.

METHODOLOGY

To support this project, the team invited two individuals to serve in an advisory capacity: Collin O'Rourke, Consumer Financial Protection Bureau (CFPB) and University of Wisconsin–Madison, and Tamra Thetford, Justine PETERSEN. The advisors provided insight on the research plan, key guiding questions, key informant discussion guide, selection of key informants, and final report.

The research began with an online survey conducted in February 2020. The survey was distributed by email to clients and members of FUND Consulting, Credit Builders Alliance, and the Community Development Bankers Association, in addition to the CDFI Connect Community at large via Opportunity Finance Network's (OFN) listserv. The survey was open to all CDFIs with the purpose of gathering further information on the number of CDFIs offering SDCBLs or other similar loan products; learning how CDFIs use, track and report borrower credit scores; finding any available data on CDFI borrowers graduating to traditional financial institutions; and identifying potential CDFI staff members for participation in key informant interviews. A total of 103 CDFIs responded to the survey from across the industry. Of respondents, 65% represented nonprofit loan funds, 18% credit unions, 10% banks, 5% for-profit loan funds, and 2% venture capital funds.

The team conducted 10 phone interviews and received in-depth documentation from three additional CDFIs. In all, these organizations included six loan funds, four banks, one credit union, one Native CDFI loan fund, and one non-CDFI fintech start-up that works with CDFI banks. These organizations either volunteered to participate in the study or were identified by the research team.

CDFI RESEARCH PARTICIPANTS

BankPlus

BOM Bank

Bright Point Development Fund

Capital Good Fund

Chehalis Tribal Loan Fund

Community Capital of New York

First Eagle Bank

IRC Center for Economic Opportunity

Justine PETERSON

Metropolitan Consortium of Community Developers

Self Financial Inc.

Self-Help Federal Credit Union

Sunrise Banks

WHY LOOK AT CREDIT SCORES?

Credit scores determine an individual's ability to access credit for a home, car, credit card, or other needs and thus can affect their financial health, ability to grow assets, and overall quality of life. A prime score is usually required to access credit at mainstream financial institutions and can otherwise lead to receiving favorable terms and rates on their loans. Depending on the credit bureau, prime scores begin at 620 to 680. Improvements in the credit score of a SDCBL borrower therefore serve as an objective measure of success of the loan by assessing whether credit scores reach prime credit levels after the loan and create access to mainstream financial institutions.

It must also be acknowledged that there is significant evidence that credit scores are part of a financial system that is structurally racist:

> **In 2007, the Federal Reserve released a report** and made a report to Congress that found low credit scores could be predicted by someone living in a census tract that is low income or predominantly includes people of color.
>
> **A 2015 CFPB report *Data Point: Credit Invisibles* concluded** that underrepresented groups are more likely to be either credit invisible (meaning they lack a credit score with one of the three nationwide credit reporting companies) or unscorable.
>
> **In 2017, an Urban Institute study, *The Financial Health of Residents,* found** a difference nationally of almost 80 points in median credit score between areas that are predominantly white and those of people of color. This translates to below-prime and sub-prime median credit scores for areas predominantly of people of color in more than 50 of the 60 cities studied.

Due to this fundamental credit inequality, among other factors, black homeownership rates are 30% lower than for whites and the racial wealth gap is growing (America's Fair Housing Legacy, Trulia, 2017).

Therefore, one might question the utility of even looking at credit scores when CDFI borrowers are likely subject to unequal credit assessments. One might also think this unfair treatment makes it all the more important to help borrowers improve their credit scores. For the foreseeable future, however, it is certain that achieving prime credit will continue to be correlated to overall financial well-being and quality of life. Therefore, while improving a credit score will not address the overall systemic inequality, it does provide one measure to assess the impact of CDFIs in helping the underserved access financial products and services.

30%

Black homeownership rates are 30% lower than for whites

WHAT DO WE KNOW ALREADY: *PREVIOUS STUDIES OF CREDIT BUILDING PROGRAMS*

There have been several important assessments of credit building programs.

A 2016 analysis of Self-Help Federal Credit Union's Fresh Start product shows that the loan helps most borrowers increase their credit score. "Borrowers who started out unscored or with scores below 640 were those most likely to see a meaningful increase in their credit score. Unscored borrowers built an average score of 643, and scored borrowers who increased their score saw an average gain of 47 points."

In 2017, LISC released an analysis of its credit building program, which includes financial counseling and access to its Twin Accounts™ SDCBL product. The results show that participants with a Twin Account™ had double the credit score gain of non-participants and were more than twice as likely to gain a score and keep it. On average, those who had a Twin Account™ increased their credit score by 35 points, compared to a 10-point increase for non-participants.

Northeastern University released a program evaluation in 2019 that found similar results. The evaluation of the Boston Youth Credit Building Initiative "found that participants in the program were likely to raise their credit scores after 18 months, with the greatest benefit going to those with thin credit files, the 'unscorables,' getting into the game."

In June 2019, The Urban Institute released an analysis of the Working Credit NFP program, Credit Building at the Workplace: Assessing Outcomes for Participants in Working Credit NFP. The report suggested positive outcomes for participating employees between 2015 and 2017: "the share of participants with prime scores increased across all racial and ethnic identities and hourly wage levels, and the share of participants with debt in collections or delinquency declined over the 18-month program."

Justine PETERSEN has been offering credit builder loans since 2008. As reported in The Power of Credit Building, "on average, clients with no credit score reach 680 and those with low scores see a 50-point increase in six months."

The purpose of this research is to take a wider look across the industry and see if these findings hold true. The following pages present the findings of this research.

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A 2016 study showed program borrowers who increased their score saw an average gain of 47 points

CDFIS ARE VERY FLEXIBLE AND INNOVATIVE IN DESIGNING SDCBLS

SDCBLs have been provided by CDFIs for at least 20 years and are becoming more widespread as fintech companies increasingly enter this market. The survey and interviews found there are many types of SDLs offered throughout the CDFI industry, with varying structures, terms, eligibility requirements, etc. For example, some of the loans are secured and others not, and some CDFIs release the money up-front and others release funds after the loans are paid off. One innovative approach is having the loan structured as the fee for a financial coaching series.

54%

54% of CDFI survey respondents provide SDCBLs.

7.95%

CDFIs reported an average SDCBL amount of $328, a term of either 12 or 24 months, an average interest rate of 7.95%, and no credit score required.

EXAMPLE CDFI SDCBL PRODUCTS

"We do open a checking and savings account for the individual; they have to put their own money into the checking account. Again, the $500 from the loan goes into the savings but it is fully secured; they get no funds. There are no fees on the loan and the interest rate is 5%. So we try to make it very, very affordable. And we spread the payments out over 12 months."

"Our credit builder loan, we actually have two different types. We have a credit repair, and then we have what we call a 'consumer loan.' And the consumer loan started off with ... being utilized for somebody that needed help paying on a bill, or needed to get their vehicle repaired, or just somebody taking a mini vacation."

"And basically, if you want to do our financial coaching program, which is a year-long program, we talk about financial and also health wellness; then, you can pay for it by making 12 monthly payments of $15. And we report those payments to the three credit bureaus and treat that like credit builder loans. So we don't advance any money. We're basically financing the coaching servant."

"We do ours kind of more like you would have for just a personal loan, where the borrower receives a check for, typically, $240, and it is paid back through typically direct payment of $20 a month for 12 months at 0% interest."

CDFIS NATIONWIDE SHOW SDCBL BORROWERS IMPROVE CREDIT SCORES SIGNIFICANTLY

There is a wide variance in the types of data CDFIs track on SDCBLs, as identified in the survey and in key informant interviews. Nonetheless, both portions of the research provided empirical data demonstrating improvements in credit score for SDCBL borrowers as well as insights from staff.

The survey found that some organizations track many data points, including longitudinal outcomes, and others track only lending outputs. While few CDFIs have robust impact tracking programs, most track the credit scores of SDCBL borrowers. In fact, the only change in credit profile that the majority of respondents track is change in credit score (84%). Additionally, 45% track debt reduction, 32% track credit utilization on active trade lines, and 23% track the number of active trade lines.

"The borrowers who start out with no score experience major changes. They go from not sufficient info for credit score to at least 600 in six months of on-time payments."

"But what we did find was—for those individuals that come back to get their second loan, who have improved their score from loan one to loan two—the average increase is 47 points. It's significant."

"We anticipate a minor to major increase of 20-100 points depending on if they complete the full 12 months and do not have other negative reporting factors."

"The biggest improvement comes when someone has no credit (most of our borrowers, because they're new to the country, have no credit history). We've seen people go from insufficient credit to score up to the mid-600s just on the first $100 six-month repayment."

"Where it becomes less clear or less of an impact is when someone already has credit and has negative impacts on their credit. It really depends on if it's a collection versus a past-due account or bankruptcy. Sometimes a $100 installment loan really won't do much to offset some of those previous negative impacts."

CDFIS NATIONWIDE SHOW SDCBL BORROWERS IMPROVE CREDIT SCORES SIGNIFICANTLY

All CDFI survey respondents that track credit score data reported increases in credit scores:

- 59% characterize the changes they see in credit scores among SDCBL borrowers as major and 41% as minor. The borrowers who experience the major changes are those who start with no credit score or very thin files.
- The most common way they prove they are moving the needle is through changes in credit score.
- 96% of respondents find their SDCBL products extremely beneficial or beneficial to clients and others in the community.

Research participants also describe the outcomes and benefits of their SDCBL products and confirmed finding that those with no (or thin) credit files see the largest change in credit scores.

"Score improvement is concentrated heavily on those within the lowest initial credit score brackets. Individuals with credit scores below 520 saw an average score increase of 90 points, with over 85% reporting a 30-point or higher score. For those with initial scores between 521-620, clients saw an average credit score increase of 29 points, with over 56% of clients seeing an increase of over 30 points and 87% of clients seeing a score increase."

"Among borrowers who enter our programs without a credit score, 84% are able to achieve a credit score during the program. Among these borrowers, the average credit score at the end of the program is above 600."

"Potentially these folks could not have gotten a mortgage the first time, where they may have the second time."

SDCBL BORROWERS ARE MOST LIKELY TO ENTER TRADITIONAL FINANCIAL MARKET WITH CREDIT CARDS

CDFIs also identified evidence that borrowers go on to use mainstream financial products–mostly credit cards but, sometimes, other trade lines such as mortgages. Forty-six percent of survey respondents have evidence that SDCBL borrowers have graduated to non-CDFI/mainstream financial institutions. As evidence sources, respondents cited public studies, their own data, and anecdotes.

"Quite often we have them come back … a lot of times they'll use the funds they originally borrowed from the first start loan and get a shared secured credit card from us. Or they're trying to build established credit so they can move on and graduate to other types of credit. We've actually had many applicants apply for home loans with us and they were taking the SDCBL out originally to start establishing and building that credit. So, again, we don't have a great tracking mechanism in place but, anecdotally, we know that we have a lot of borrowers that have graduated to other loan products, which started with the fresh start with the credit builder."

"Yes, we have seen on those follow-up check-ins, when we pull credit again, we can see more active trade lines—primarily in credit cards. Many times our clients will start with secured credit cards with some of the more mainstream financial institutions, but then get into unsecured credit cards as well."

"We get people that … if they don't have a bank … I talk to them about getting a credit card and just using it for small purchases, like maybe gas, and then paying it off in full and putting it away until the next month, just to build their credit up."

"For many clients, we recommend—once they complete the credit builder loan—that they open a secured credit card. We work with what I would certainly call traditional financial institutions to open those credit cards."

TARGET SDCBL BORROWER AS IDENTIFIED BY RESEARCH PARTICIPANTS

- For those with credit scores, the sweet spot is those with credit scores of 600-620
- Willing to commit to a 12-month term; 24 is too long and you want at least 12 months to help credit
- The ideal candidate is for the borrower with no credit score
- Other good candidates include those with lower credit scores; those with thin files and fewer than three credit lines (and not as suitable to those with existing debt and many active trade lines).
- The terms most commonly used to describe the borrowers CDFIs are trying to attract are "low income," "immigrants," "unscored," "credit invisible," and those who would use payday lenders.

CDFI INDUSTRY IS COMMITTED TO LONG-TERM OFFERING OF SDCBLS FOR MISSION REASONS

The findings show that SDCBL programs are not profitable—60% of respondents strongly disagree or disagree that their SDCBL product is profitable. Nonetheless, 76% of respondents strongly agree or agree that their SDCBL program is successful, suggesting CDFIs provide SDCBLs primarily to support their mission or other business reasons. For some, it also makes business sense as a pipeline for other products, such as mortgage lending, and to provide a product for borrowers where banks otherwise see highest losses. The vast majority (80%) of CDFIs anticipate continuing to offer the product for the next 10 years.

60%

60% of respondents strongly disagree or disagree that their SDCBL product is profitable.

"In fact, we lose money doing these loans, but what it does is it opens the door. It starts the relationship off well in that someone would trust us because we're not charging any money for this. We recognize that we are, in fact, losing money by doing this, but we value the trust that's built from this product and we know that the other products we offer bring in enough revenue to allow us to continue to offer this product."

"This is where 48% of our losses are coming from, this segment right here. From 450 to 500 credit scores. We can drop our charge-off significantly if we just put into play this credit builder program."

"I don't see us ever questioning should we offer them, but we often discuss how we can offer this product without it being so costly."

"[W]e definitely see it as a mission-impactful product."

CONCLUSION

Our findings support the conclusion that, through providing SDCBLs, CDFIs are generating significant impact in helping borrowers improve credit scores as well as facilitating moves into more traditional financial markets. CDFIs are able to be creative with these products, and find them useful to borrowers as well as for mission and business reasons. In moving forward, some thoughts for consideration by CDFI industry stakeholders:

> Are there opportunities to generate cost savings in program administration through partnerships with other CDFIs or fintech companies?
>
> Could efforts be made to standardize key outcome data across the CDFI industry?
>
> Are there ways to work toward alignment of the CDFI industry and the credit building industry in product terminology usage?

As always, when working with the CDFI community, FUND CI is grateful for those who completed the survey, provided key informant interviews, and provided guidance through the Advisory Board.

We sincerely thank all who participated.

FUND Community Institute

INTERESTED IN STARTING OR IMPROVING YOUR SDCBL PRODUCT?

Credit Builders Alliance will shortly be releasing its Credit Builder Loan Toolkit that will be available on its website. This document provides comprehensive data and examples on how to structure a credit builder loan (specifically for credit-building purposes), launch the product, partner with other organizations, track data, and support borrowers.

Credit Builders Alliance

CBA was created in 2007 by and for our nonprofit members in response to a serious gap in the modern credit reporting system that locks millions of individuals with poor or no credit out of the mainstream financial system. CBA's core services provide our 550+ members with the ability and support needed to report loan data to the credit reporting agencies and to pull client credit reports for financial education, outcome tracking and underwriting. Our Training Institute provides robust training, tools, and up-to-date industry information that equips practitioners to help clients build credit and reach financial goals. Through this support, CBA helps people and small businesses who are outside of or underrepresented in the financial mainstream build credit to achieve their goals and enjoy financial resiliency. For more on CBA, go to **creditbuildersalliance.org** and follow us on Twitter at **@Credit_is_Asset.**

THE FUND FAMILY

The FUND Family of organizations works collectively to facilitate positive social, economic, and environmental impacts through consulting services, research, training, and facilitation of opportunities for knowledge sharing. Consisting of FUND Community Institute (a nonprofit think tank) and FUND Consulting (a for-profit consulting firm), FUND delivers high-quality services with a focus on supporting organizations and practitioners fostering positive outcomes in communities nationwide. The leadership of both organizations has certifications in Fostering Inclusion and Diversity from the Yale School of Management.

For questions, please contact Ruth Barber at ruthbarber@fundci.org.

Learn more: www.fundci.org