BUILDING CREDIT WHERE IT'S NEEDED

Why Workforce Programs Should Focus on Credit

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October 2014

When Eugene R. was released from prison in 2012, he went to several organizations to look for help getting a job. All of them turned him down because of his record—except for the North Lawndale Employment Network (NLEN), whose U-Turn Permitted program is specifically designed to help ex-offenders. After he completed the four-week program, Eugene was hired as a receptionist at NLEN, making minimum wage.

By living with his mother, Eugene was able to save some money and soon had his heart set on a 2005 Cadillac CTS. "I had been saving my money to buy a car. I went to the dealership and I was telling the guy I had $2,500, but he wouldn't let me walk off the lot with that car because I had no credit. He turned me down and the very next day he sold the car to someone else with only $500 down."

Eugene had not taken advantage of NLEN's financial counseling program, but now he realized he needed to improve his credit. "You can have all the cash you want, but it is not going to matter if you have no credit." He enrolled in NLEN's Twin Accounts program (see description below) and began making monthly payments on a loan to improve his credit. Within six months Eugene had moved from being unscored to having a prime score of 677, and once again he began looking to buy a car—which he now needed desperately to replace the aging Ford Taurus that he used to commute to his new job at a candy manufacturer outside of Chicago, about 30 minutes from home by automobile, but nearly impossible to reach by public transportation.

But before he purchased a car, Eugene used his improved credit history to get a credit card from Kay Jewelers, which he let his brother use to buy a bracelet for his girlfriend. Despite promises to the contrary, Eugene's brother failed to make the payments on the card. When Eugene found out, he paid off the entire balance, but it was too late—the card was canceled and his hard-earned credit record was damaged, dropping his score to 588, which lenders consider subprime.

While many people have occasionally forgotten to pay a bill or overdrawn a checking account, most consumers have not faced the consequences of chronic bad credit, or, worse, having no credit at all. For the poor, whose high-wire financial juggling often leads to credit problems, bad credit brings a host of challenges that exacerbate already-difficult financial circumstances.

FICO credit scores range from 300 to 850, and many lenders consider anything below 620 subprime. It is difficult for consumers with subprime scores to access credit and when credit is offered, it often comes at a steep price. For example, First Premier Bank's MasterCard is marketed to people with subprime scores. But applicants are required to pay a $95 application fee, a $75 fee for the first year ($45 thereafter), and a monthly fee of $6.25 after the first year; the bank also charges 36 percent interest on any monthly balance.[1]

Most people have to borrow money to make major purchases. For someone with a FICO score of 700–759 to purchase a home at current interest rates, a $150,000 30-year fixed mortgage would entail a monthly payment of $716. A borrower with a credit score of 620–639 would pay $839 each month, which might not seem like that much more, but it adds about $44,000 to the total interest paid over the life of the mortgage. Similarly, people with poor credit also pay more when they borrow to buy a car. A four-year used-auto loan of $5,000 would require someone with poor credit (a FICO score of 500–589) to pay about $2,100 more in interest payments than someone with good credit.[2]

Credit can be crucial for car owners, too. If their car breaks down on the road, most people can call a towing company and get assistance by reading the 16 digits on their credit card. Those without a credit card must have someone come pick them up and then either use savings, borrow money from friends or family, or go to an alternative lender for the cash—which makes the repair many times more expensive than it would be if they'd had credit.

Businesses consult individuals' credit histories when their clients purchase insurance, set up a utility account, rent an apartment, or apply for a job. In 2012, 13 percent of companies surveyed by the Society for Human Resource Management reported that they checked credit reports for all job candidates, and another 34 percent said they checked them for selected positions.[3]

According to a Federal Reserve paper released in September 2014, nearly 28 percent of American families reported that they had either been denied credit or decided not to apply for credit for fear that they would be turned down.[4] People without access to credit typically live in the cash economy, relying on check-cashing outlets, payday lenders, and prepaid utilities and cellular phones, all of which entail fees and/or deposits that reduce these individuals' available resources. Without a credit card, many people resort to purchasing major items from rent-to-own stores, whose business model succeeds because they are able to collect far more in monthly payments than an item would have brought in if purchased in full. Furniture, televisions, computers, and even clothes are featured in the rent-to-own stores prevalent in low-income neighborhoods.

As a result, people with poor credit not only have less income but also find it harder to save money, weather financial crises, and invest in themselves and their children. Little had been done to address these issues as part of a broader poverty alleviation strategy until the Annie E. Casey Foundation began supporting Centers for Working Families (CWFs), which integrate financial counseling with employment counseling, assistance accessing benefits, and, in some cases, help with tax preparation. In 2014, more than 100 CWFs were operating across the country, including 70 supported by the Local Initiatives Support Corporation (LISC).

In 2010, with support from the MacArthur Foundation and the Social Innovation Fund, Mobility began a rigorous evaluation of LISC's version of the CWF strategy, called Financial Opportunity Centers (FOCs). The evaluation focuses on the work of five Chicago community groups: Instituto Del Progreso Latino, the Cara Program, Association House, Metropolitan Family Services, and the North Lawndale Employment Network. When Mobility began the evaluation, most of the organizations had been implementing the model for a few years and were regarded as among the strongest of the 11 LISC-supported Financial Opportunity Centers in Chicago.

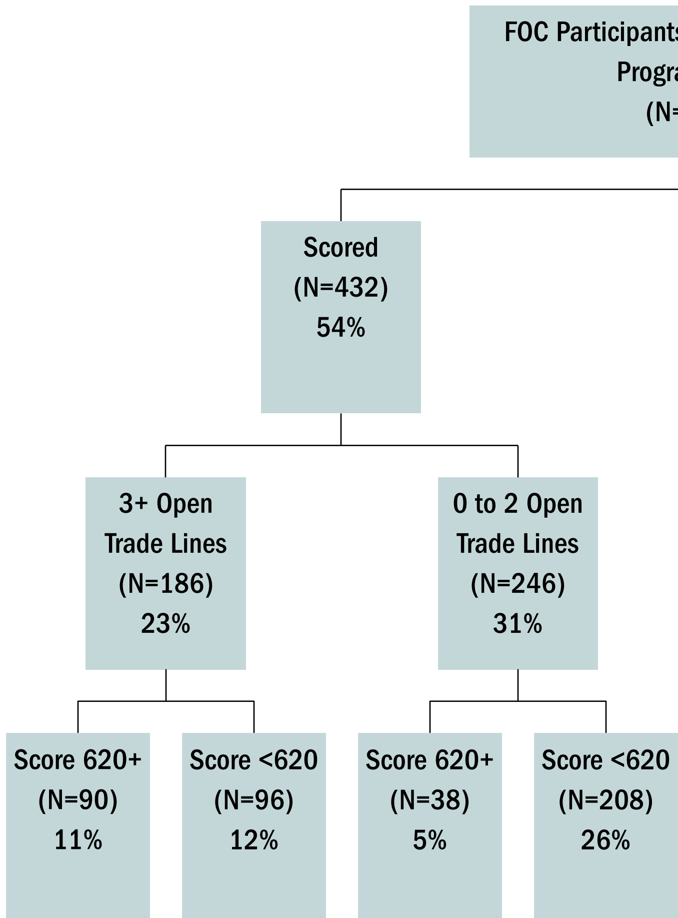
FOCs strive to help individuals achieve several goals: becoming consistently employed, improving their FICO credit scores, and increasing net income and net worth. FOCs provide individuals with a combination of financial counseling, employment assistance, and help accessing public benefits to supplement income from work. The FOC model stipulates that the three core services work best when they are integrated. Organizations first seek to help participants achieve positive net income by becoming employed, obtaining public benefits, and reducing expenses. FOCs then try to engage participants in credit-building activities in order to improve their credit scores, which, in turn, are expected to further help them reduce expenses, access low-cost forms of credit, and build wealth.

Much of the data for this brief comes from Mobility's interim evaluation report, which focuses on FOC participants' credit profiles one year after program enrollment. The analysis of program impacts uses propensity score matching with a comparison group of people who were seeking assistance with employment and training from the city of Chicago's workforce centers during the period FOC participants were enrolling. Study enrollment took place from October 2011 to August 2012.

Participant Credit Profiles

In general, the participants seeking assistance from the five FOC groups had very poor credit profiles or no profiles at all at the time of enrollment. As shown in **Figure 1**, 46 percent of FOC participants did not have a credit score at the time of program entry because they did not have active loans, credit cards or other lines of credit. Just 16 percent of all FOC participants had prime scores of 620 or above. Participants' scores ranged from 434 to 808; the median score at program entry among those with scores was 568; the average was 586.

Figure 1. FOC Study Participants' Credit Profiles



Just over half of FOC participants (54 percent) had active trade lines on their credit reports that allowed them to be scored. More than 70 percent of these participants had subprime scores (below 620), while among the general population only about 25 percent of American consumers with credit scores had subprime scores.[5]

Among the 54 percent of participants with scores, just under half had three or more open trade lines (primarily loans or credit cards) on their credit reports,. The majority of the scored participants had two or fewer open trade lines, a situation referred to as a "thin file." Many lenders will not offer their best terms to applicants with thin files, as there is not as much information available for them to review.

The credit profiles of the scored and the unscored were markedly different.

While eight out of 10 scored participants had any open trade lines when they enrolled, just one in 20 of the unscored had any open accounts (Figure 2). Because scored participants had more trade account activity, they were more likely to have accounts with negative ratings either because their most recent payment was made late or the account was in collections or charged off to bad debt. The scored participants were seven times more likely to have trade accounts with a positive balance. The average debt on these accounts was nearly $30,000 at the time of enrollment.

Figure 2. Credit Activity on FOC Participants' Credit Reports at the Time of Program Entry

	Unscored (N=370)	Scored (N=432)	All (N=802)
Any activity on report	74%	100%	88%
Any collections	54%	75%	66%
Any derogatory public records (bankruptcies, liens, or civil judgments)	12%	26%	19%
Any inquiries into credit history	57%	85%	72%
Any trade accounts (open or closed)	23%	100%	64%
Any trade accounts with negative ratings	17%	74%	48%
Any open trade accounts	5%	79%	45%
Installment accounts (loans)	2%	52%	29%
Revolving accounts (credit cards or lines of credit)	0.3%	37%	20%
"Open" accounts (e.g., utility, child support accounts)	2%	26%	15%
Any trade accounts with positive balances	13%	91%	55%
Average trade account debt among those with positive balances	(N=49) $19,155	(N=395) $29,665	(N=444) $28,505

Younger and less-educated participants were less likely to have a credit score.

FOC participants who were 18 to 24 when they enrolled were much more likely to be unscored than their older counterparts (Figure 3). Similarly, participants without a high school degree were about three times more likely to be unscored at program entry than participants with college degrees (Figure 4).

Figure 3

Percent Unscored by Age

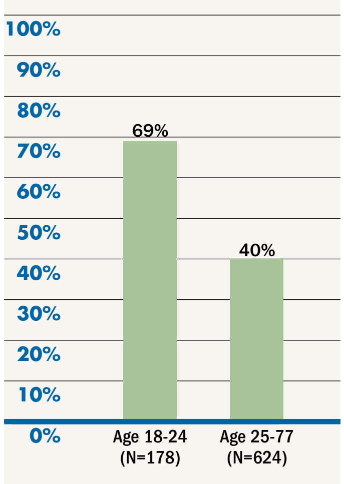


Figure 4

Percent Unscored by Educational Level

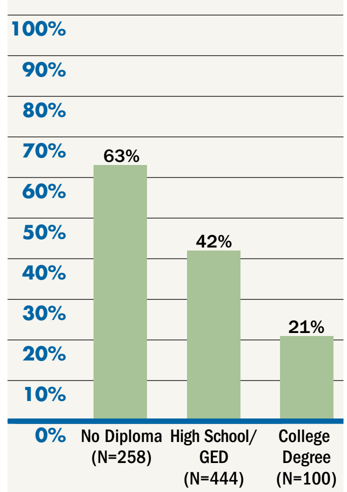
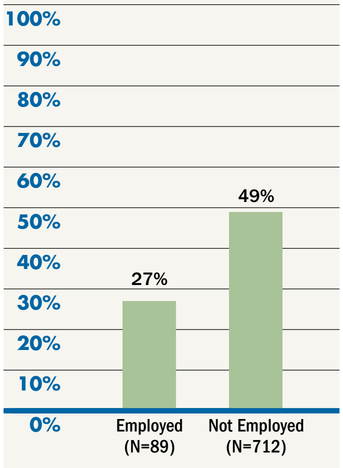


Figure 5

Percent Unscored by Employment Status



Unemployed participants were much more likely to be unscored.

The study involved individuals seeking assistance with employment or job training. Therefore, it is not surprising that nearly nine out of 10 FOC participants were unemployed when they enrolled in one of the FOCs. About half of the unemployed participants were unscored when they enrolled, compared to just 27 percent of those who had jobs (Figure 5).

Among those with scores, unmarried and less-educated participants were more likely to have subprime scores when they enrolled.

Among FOC participants who had credit scores, those who were not married or living with a partner when they enrolled were much more likely to have subprime scores than their married counterparts (Figure 6). Similarly, participants with less education than a college degree were also more likely to have subprime scores (Figure 7).

Figure 6

Percent Who Had a Subprime Score by Marital Status, Among Those With Scores

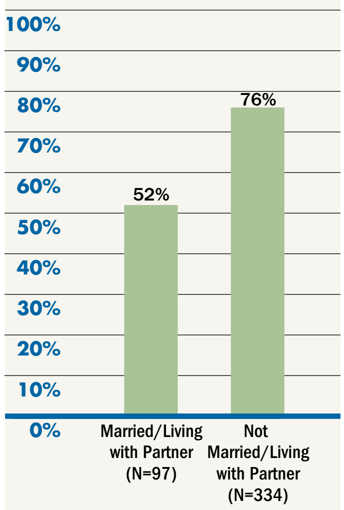
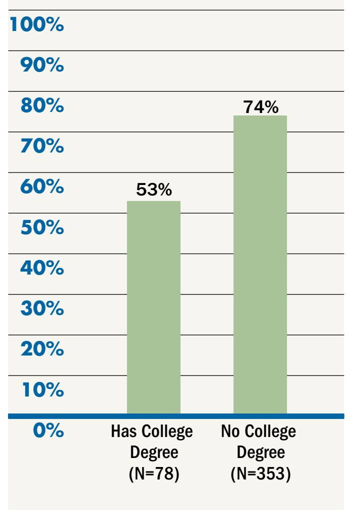


Figure 7

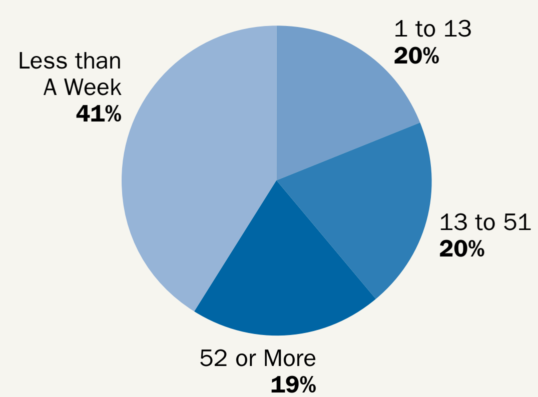
Percent Who Had a Subprime Score by Education Level, Among Those With Scores



Program Participation

Across the five sites, participation varied widely. The FOC programs did not typically have an established duration; participants were encouraged to continue until they reached their goals. Overall, 41 percent of the 802 participants received services for a week or less. On the other hand, 39 percent received services for three months or longer, as illustrated in Figure 8. Thirty percent of all participants received the full bundle of employment, financial, and income support counseling services; 45 percent received both employment and financial counseling.

Figure 8 **Weeks of Participation Among All FOC Study Participants (N=802)**



Preliminary Findings

The FOCs' principal credit-related goals were to help participants who were unscored at program entry to become scored, and to help those with scores, particularly subprime scores, to improve them. One year after enrollment, we found the following outcomes.

- **Participants' credit profiles showed no improvement relative to those of the comparison group.** In fact, a higher percentage of both groups had become unscored during the year after program entry, while those who had entered the program with credit scores experienced little change in scores (Figures 9 and 10). The decrease in scored participants in both the program and comparison groups may reflect a general tightening of credit during the recession.

- **FOC participants made significantly more on-time payments on their trade accounts than the comparison group did.** They were also significantly more likely to pay any trade accounts on time (Figure 11). This suggests that building a positive credit history and improving credit scores may take more than a year for financially distressed or unemployed families—even those who begin to manage their credit more responsibly.

Figure 9 Percent of All Study Participants Who Had A Credit Score

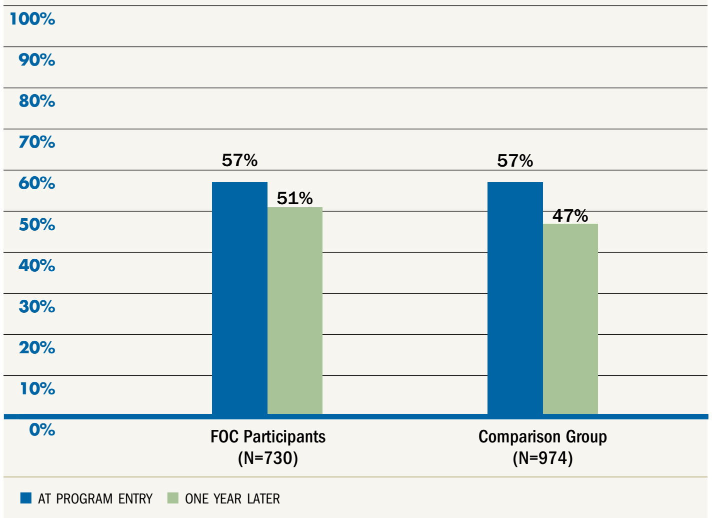


Figure 10 Average Credit Scores Among All Study Participants Who Had Scores Both at Program Entry and One Year Later

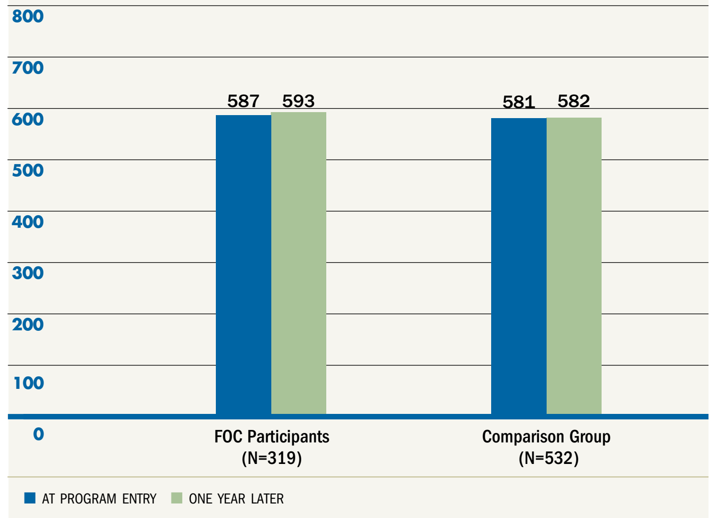
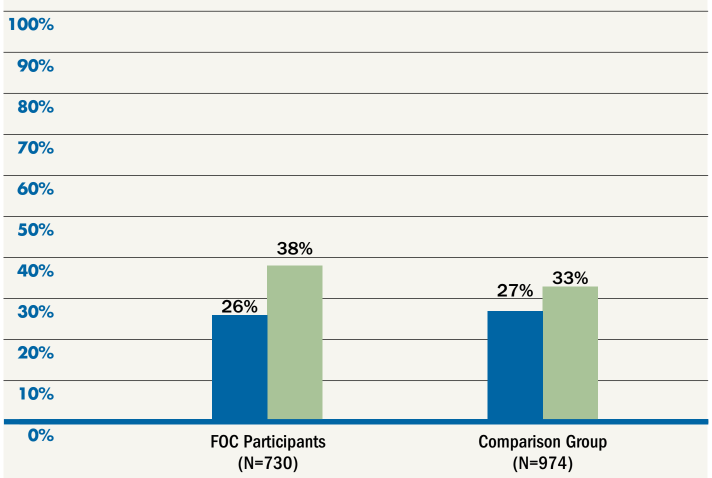
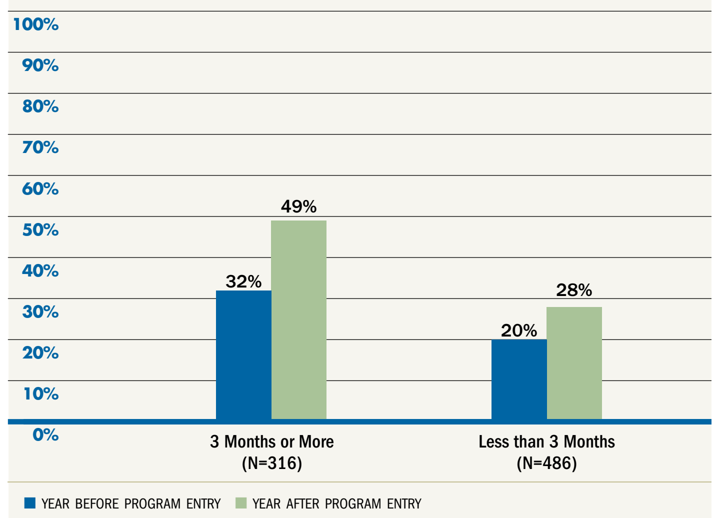


Figure 11 Percent of All Study Participants Who Paid Any Trade Accounts on Time



Note: Difference significant at p<.05 level

Figure 12 Percent of FOC Study Participants Who Paid Any Trade Accounts on Time by Length of Program Participation



- **Participants who received FOC services for three months or longer were significantly more likely to pay any of their trade accounts on time.** (Figure 12) They were also more likely to remain scored. However, receipt of bundled services in all three areas was not associated with improvement in any of the key credit outcomes. Receipt of bundled services may be associated with other outcomes, something that will be examined in-depth in the final evaluation report in 2015.
- **FOC participants who were 25 years or older were more likely than their counterparts in the comparison group to have experienced either an increase in credit score or to change from being unscored to scored during the year after program entry.** Older participants were more likely to have credit scores a year after program entry and to have made payments on trade accounts during the year.

Twin Accounts

To help low-to-moderate-income families simultaneously build credit and save money, LISC developed the Twin Accounts program as a credit-building product that financial counselors could offer participants. Twin Accounts was developed partly in response to the difficulty FOC participants had gaining access to credit during the recession. Twin Accounts participants are issued a 12-month $300 loan, the proceeds of which are transferred to a locked savings account, where the money remains until the loan is paid off. Interest on the loan is fixed at 9 percent for the term of the loan. Participants make monthly payments of $26.24, which are reported to the major credit bureaus by LISC's financial partner, Justine PETERSEN. LISC matches each monthly payment dollar for dollar, but only if the payment reaches the lender on time, which serves as an incentive for participants not only to take part in the Twin Accounts program but to engage in credit-building behavior. At the end of the loan term, participants who make 12 on-time payments have $300 in savings, $300 in matching funds from LISC, and improved credit as a result of making on-time payments on a debt that is reported to the credit bureaus. LISC limits use of the match funds earned to opening a secure credit card so that participants may continue to build credit after the 12-month loan is paid off.

To be eligible for a Twin Account, individuals must want to improve their credit, have sufficient income to cover the monthly loan payment, and have either no credit score or a subprime score at program entry. Less than 2 percent of all FOC participants in the study, 3 percent of participants who received any financial counseling, enrolled in Twin Accounts during the study period.

While the number of FOC participants enrolled in Twin Accounts during the study was too small to draw any firm conclusions about its effectiveness, it is worth noting that among the 14 who did enroll, the number of scored participants increased from six at program entry to 11 one year later, and the number who had a score of 620 or greater increased from two at program entry to eight one year later.

Implications for the Field

Overall, the FOC programs demonstrated no statistically significant impact on participants' credit profiles, including their FICO credit scores, one year after enrollment. However, a number of the findings cited above suggest that LISC's credit-building approach holds promise. Although full conclusions about the initiative will have to wait until the final report is issued, in 2015, our analysis of credit data, which is the main focus of this report, suggests several implications for the field, particularly for workforce development organizations.

- **Building credit requires a long-term strategy.** Short-term interventions are unlikely to produce the sustained changes that are required to improve people's credit. However, the use of credit-building products such as Twin Accounts may accelerate gains—especially for the unscored—as long as they have net income after becoming employed that can be used to make consistent on-time payments.

- **Credit building could be a crucial tool for more-intensive workforce programs.** Program graduates starting full-time jobs that pay well are ideal candidates for credit building since they will likely have the resources to make regular payments on lines of credit. Financial education and counseling should begin early in the program, as it is essential that participants develop not just an understanding of the importance of credit but also a trust in program staff that will sustain the relationship until credit-building can take place.

- **Programs like Twin Accounts could substantially strengthen employment retention strategies while improving people's credit.** Many workforce programs struggle to stay in touch with their graduates. Enrolling them in a program like Twin Accounts, which requires monthly loan payments over the course of a year, would not only support participants' credit-building behavior but also offer a means of maintaining contact after graduation.

- **Targeted strategies may be needed to engage young adults.** The FOC programs had more success engaging older participants. Programs focused exclusively on youth may be better able to engage younger adults in credit building. As our analysis has shown, young adults entering employment programs are more likely to be unscored, making them excellent candidates for counseling focused on credit building.

Participants' credit profiles have been an overlooked component of most workforce development programs (and of poverty alleviation strategies more broadly). Credit scores have become a central factor in people's economic lives: poor credit and lack of credit have devastating consequences for many people, consequences that not only damage their labor-market prospects but take a disheartening toll on their everyday finances.

Eugene eventually found a 2003 Ford Explorer that he liked for about $8,500. When he first visited the dealership, he was told that he could get a loan for 9 percent, but when he came back the dealer said the rate would actually be 26 percent because his credit was still subprime after the Kay Jewelers debacle. Eugene contacted more than a dozen lenders but couldn't find a better offer. So he put $2,000 down and financed the remainder over three years. Every month, $269 is withdrawn directly from his bank account, which will amount to $9,686 by the time the loan is paid off.

Eugene has been making his auto loan payments consistently for several months, which is making him more attractive to lenders. "I get so many pieces of mail now, some from the same companies that were denying me. 'You're preapproved for this or preapproved for that.' I just scrap it. I just throw it away," he says, laughing. "I do have a Visa card now—from a major bank."

Endnotes

1. Details can be found at www.premiercreditcardsf.net. *Accessed September 24, 2014.*
2. Figures were calculated using www.myfico.com/myfico/CreditCentral/LoanRates.aspx. *Accessed August 21, 2014.*
3. Society for Human Resource Management (SHRM). 2012. *SHRM Survey Findings: Background Checking—The Use of Credit Background Checks in Hiring Decisions.* http://www.shrm.org/research/surveyfindings/articles/pages/creditbackgroundchecks.aspx. *Accessed August 20, 2012.*
4. Jesse Bricker et al. "Changes in U.S. Family Finances from 2010 to 2013: Evidence from the Survey of Consumer Finances." Federal Reserve Bulletin, September 2014. http://www.federalreserve.gov/pubs/bulletin/2014/articles/scf/scf.htm. *Accessed September 22, 2014.*
5. See http://bankinganalyticsblog.fico.com/2014/02/us-credit-quality-continues-to-inch-forward.html. *Accessed September 24, 2014.*

Acknowledgments

We would like to express our gratitude to Eugene R. for sharing his perspective with us and allowing us to share it publicly. Stacey Woods from the North Lawndale Employment Network provided us with helpful context for Eugene's experience. Several people read the brief and provided useful suggestions, particularly Ricki Lowitz and Sarah Rankin from LISC, and Kristin Schell at Justine PETERSEN. Their comments helped clarify many credit-related issues discussed in the report. The MacArthur Foundation provided us with the support to begin our evaluation of LISC's Financial Opportunity Centers. We especially want to thank Craig Howard, director of community and economic development at MacArthur, for introducing us to LISC's work in this area. The evaluation was supported primarily by the Social Innovation Fund, a program of the Corporation for National and Community Service. We also want to express our gratitude to the Annie E. Casey Foundation, Citi, Walmart Foundation and MetLife Foundation for making grants to LISC that supported Mobility's work. Caitlin Van Dusen copyedited the brief, making our prose considerably more accessible. Finally, Penelope Malish did her usual terrific job with the brief's design.

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The Economic Mobility Corporation (Mobility) identifies, develops and evaluates programs and policies that enable disadvantaged individuals to acquire the education, skills and networks needed to succeed in the labor market so that they can support themselves and their families.

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