

# Racism and the Economy

focus on **Financial Services**

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Title of proposal: Bridging the Racial Wealth Gap Through Credit Building

*The views and ideas expressed in this proposal are those of the authors. They do not necessarily reflect those of the Federal Reserve System or the Federal Reserve Banks that host events in the Racism and the Economy series.*

## **Abstract**

In the United States, approximately 45 million people are credit invisible and unscorable. Without a credit score, it is extremely difficult to access credit, housing, and high-quality financial services. The vast majority of those excluded from the financial system are immigrants, minorities, students, and renters. The concept of wealth in America is predicated on access to cheap debt and high-quality financial services. Therefore, the challenge is not that the products, tools, and resources do not exist, but rather a massive segment of society is unable to access those products and services. Factoring rental data, the largest monthly expense for low- to medium-income households, into credit scores can generate an outsized impact and create pathways to wealth building, especially in Black and Brown communities. To that end, we are calling on Congress to pass a nationwide law that mandates the reporting of on-time rental data into the credit bureaus.

## **Background**

The Fair Isaac Corporation (FICO) and VantageScore Solutions (Vantage scores) are widely used to predict credit risk in the United States. FICO and Vantage generate scores ranging from 300 to 850.<sup>1</sup> Most lenders in the United States leverage both scoring models to determine the likelihood of repayment. A score above 760 (prime credit) was considered good by most lenders, while scores below 620 (sub-prime) were considered poor by lenders. Without a credit score, it is extremely difficult to access credit, housing, and high-quality financial services.

Life is equally expensive with a poor credit score. For example, As of November 2021, the difference between getting a \$200,000 principal on a 30-year fixed-rate mortgage with a 620-credit score is \$155,631 total interest while a 760-credit score is \$91,840.<sup>2</sup> This means the individual with a 620-credit score will pay (\$155,631 - \$91,840) \$63,791 more in interest over the life of the mortgage. Credit invisibility or poor credit is expensive, routes directly to financial instability, and currently has millions in the United States living on the brink of financial ruin.

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<sup>1</sup> Forbes: <https://www.forbes.com/advisor/credit-score/fico-vs-vantagescore-credit-scores-whats-the-difference/>

<sup>2</sup> The Balance: <https://www.thebalance.com/mortgage-rates-by-credit-score-4171904>

To understand the complexities of the credit crisis you must understand the critical role that race has played in the United States. Richard Rothstein's *The Color of Law* details how federal housing policies in the 1940s and '50s mandated segregation and undermined the ability of Black families to own homes and build wealth. The United States federal government pursued two important policies in the mid-20th century that segregated metropolitan areas. The first was a civilian public housing program that frequently demolished integrated neighborhoods to create segregated public housing. The second was the subsidization of suburb development to a condition that they are only sold to White families. These two policies laid a foundation for systemic patterns of segregation and disenfranchisement that removed generations of people of color from homeownership and wealth-building.

The largest generator of wealth in this country is homeownership. Historically, people of color, minorities, and immigrants were broadly excluded from benefiting from housing benefits. With the looming legacies of slavery, Jim Crow, redlining, and undervaluing homes and assets in Black neighborhoods, we have seen intentional, systematic policies that limit wealth creation amongst people of color. Progress requires a strategy that empowers those who have long been counted out and forced out by creating a pathway to homeownership through credit building that residents can realize during their lifetimes.

The concept of wealth in America is predicated on access to cheap debt and high-quality financial services. Therefore, the challenge is not that the products, tools, and resources do not exist, but rather that a massive segment of society is unable to access those opportunities. From a policy perspective, we should focus on strategies that will produce high-quality financial products for low-to-moderate-income households, including bringing consumers on a journey from financial identity and stability towards financial wellness and, ultimately, wealth building. The vision at Esusu is to unleash the power of data to bridge the racial wealth gap.

### **Proposal: Leverage the Power of Rental Data to Build Credit Profiles**

Every month, over 109 million Americans send on average \$1,100 in rent to property owners (\$1.44 trillion annually).<sup>3</sup> For many, rent is their most significant monthly expenditure, on average amounting to more than 35 percent of monthly income. Rental housing payments are often the largest monthly expense for working families, but these on-time payments are not traditionally counted in credit reports. However, missed rental payments are reflected and can be reported to the credit bureaus. Homeowners get credit for paying their mortgage so renters should receive that same benefit. Fewer than 10 percent of renters<sup>4</sup> see their on-time rental payment history reflected in their credit scores.

Fintech company Esusu saw the potential of leveraging technology to include non-traditional information such as rent in credit reporting. The objective is to give renters the same credit benefits that homeowners receive for making their mortgage payments. By reporting on-time rental payments

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<sup>3</sup> Property Management: <https://ipropertymanagement.com/research/renting-statistics#regional-statistics>

<sup>4</sup> Freddie Mac: <https://www.globenewswire.com/en/news-release/2021/11/03/2326350/0/en/New-Freddie-Mac-Initiative-Helps-Renters-Build-Credit.html>

to the three major credit bureaus (Equifax, Experian, and TransUnion) renters can build credit debt-free. If renters boost their credit scores, that will ultimately unlock pathways to key milestones including but not limited to homeownership, buying a car, accessing education opportunities, and more. This innovative model sparks credit opportunities from expenses that renters are already paying and simultaneously encourages on-time payments—a massive win for both residents and property owners.

Data released by the Consumer Financial Protection Bureau in 2015 confirmed that approximately 45 million Americans are credit invisible and unscorable, and 26 million of the 45 million are "credit invisible."<sup>5</sup> This figure indicates that one in every 10 adults does not have a credit history with one of the three nationwide credit reporting companies (Equifax, Experian, and Transunion). An additional 19 million consumers have "unscorable" credit files, which means that their file is thin and has an insufficient credit history, stale files, or lack recent credit history.<sup>6</sup> Blacks are more likely than Whites to be credit invisible or to have unscorable credit records. About 15 percent of Blacks are credit invisible compared to 9 percent of Whites. This data illuminated the gap in the credit system in the United States, but it also pointed to an opportunity to leverage data to score renters and provide capabilities that are valuable to property owners looking for ways to ensure payments and cash flow. Esusu's research found that 7 out of 10 renters are more likely to pay on time with rent reporting.<sup>7</sup> This data also showed that 2 out of 3 renters prefer apartments with rent reporting. For many, rent is the most significant monthly expenditure, on average totaling more than 27 percent of monthly income.<sup>8</sup> Esusu's model ensured that 100 percent of credit invisible renters are scorable once they reported rent. This creates a pathway to scoring millions nationwide.

Existing research highlights that access to credit is an underlying problem for millions of people living on the margins. Many working families do not have enough money saved to offset a major emergency expense. More than half of Americans<sup>9</sup> have less than three months of emergency savings. Recognizing that for many households the cost of signing up for rent reporting could be cost-prohibitive to many working families, Esusu decided to partner directly with multi-family property owners. These partnerships would offset the costs for renters and scale rent reporting faster.

### **Scaling for Impact: Esusu Case Study**

To help scale and drive this massive shift, Esusu sought national partnerships with the country's largest property owners, asset managers, and government-sponsored entities to capture, transform,

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<sup>5</sup> CFPB: <https://www.consumerfinance.gov/consumer-tools/credit-reports-and-scores/answers/key-terms/>

<sup>6</sup> CNBC: <https://www.cnbc.com/2015/05/05/credit-invisible-26-million-have-no-credit-score.html>

<sup>7</sup> TransUnion: <https://newsroom.transunion.com/rent-reporting-will-motivate-seven-in-10-renters-to-make-more-on-time-payments/#:~:text=TransUnion%20research%20finds%20rent%20payment%20reporting%20can%20benefit%20both%20renters%20and%20property%20managers&text=The%20survey%2C%20commissioned%20by%20TransUnion,payments%20to%20a%20credit%20bureau>

<sup>8</sup> National Apartment Association: <https://www.naahq.org/news-publications/apartment-affordability-percentage-rent-income>

<sup>9</sup> Bankrate Survey: <https://www.bankrate.com/banking/savings/emergency-savings-survey-july-2021/>  
<https://www.inc.com/sophie-downes/esusu-abbey-wemimo-samir-goel-serena-williams-nigeria-credit-scores.html>

and report on real-time data into the three major credit bureaus (Equifax, Experian, and Transunion). Esusu partnered with 35 percent of the largest 100 asset and property managers in the United States representing over 2.5 million rental units (as of August 2021). Esusu expects to work with 60 percent of the top 100 owners by the end of 2022. Esusu also integrated with the largest software providers for property management companies that cover 80 percent of rental units in the United States, providing Esusu with access to rental payment data to streamline reporting.

Esusu renters reported an average credit score increase of +51 points. Thousands without a credit score established-prime scores with Esusu. To date, Esusu has helped over 150,000 renters improve their credit scores by reporting their rent. From this collective data footprint, we understand that rent reporting positively impacts both the property manager and the renter by increasing on-time payments, preventing evictions, and lowering vacancies.

### **Conclusion**

Numerous historical events have led to the credit disparities and marginalization of low- to moderate-income households, especially for people of color. The average household debt in the United States is \$92,000. If we multiply \$92,000 by 45 million, that's over \$4.1 trillion we can unlock for the households, potentially hundreds of millions in tax revenue and substantive contribution to GDP. Rent reporting presents a great opportunity to help households establish or build their credit scores, which could lead to access to quality financial products. There is a three-pronged approach to address credit disparities: (1) leveraging innovative technologies for data reporting, (2) providing incentives for asset managers and landlords to adopt rent reporting, (3) engaging diverse stakeholders (government, private sector, and civil society) to drive policy through execution. To that end, we are calling on Congress to pass a nationwide law that mandates the reporting of on-time rental data into the credit bureaus.