BRIDGING THE GAP BETWEEN SUPPLY AND DEMAND: THE EVOLUTION OF THE HOMEOWNERSHIP, EDUCATION AND COUNSELING INDUSTRY

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1919 Pennsylvania Avenue, NW, Suite 775
Washington, DC 20005

Institute Report No. 00-01

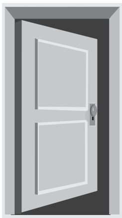
May 2000

RESEARCH INSTITUTE for HOUSING AMERICA

ISSN# 1529-4633

Published by:
The Research Institute for Housing America
1919 Pennsylvania Ave., NW
Suite 775
Washington, D.C.20006-3538

FOREWORD



I am proud to introduce the Institute Report series, a new vehicle for publishing research and analysis funded by the Research Institute for Housing America (RIHA). The Mortgage Bankers Association (MBA) launched RIHA in 1998 to create knowledge that expands housing opportunity for all Americans, particularly for minorities, low-income families, and immigrants. The Institute's research identifies ways to eradicate lending and housing discrimination, recommends improvements to mortgage market practice to better reach traditionally underserved populations and communities, and analyzes the costs and benefits of homeownership.

While serving as President of the MBA, I have been proud to see the mortgage banking industry continue its efforts to combat discrimination. MBA recognizes that knowledge is power—the power to open doors to housing opportunity and increase access to the American Dream. Our industry continually stretches to reach people not adequately served by current products and services. RIHA is a key partner in our commitment to open new markets and ensure all that seek homeownership receive fair and equitable treatment.

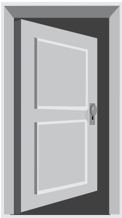
In particular, I am pleased to see this report published as the first tangible outcome of the National Homeownership Summit, held by the MBA last November at the University of Virginia. Summit participants identified, as a key research priority, the need for a better understanding of the value of education and counseling as a tool to increase homeownership. This study identifies and expands the range of value these efforts bring to lenders and consumers, and frames the future research agenda for the industry.

This report is the first in the Institute Report series. These publications translate research findings into practical knowledge and information on how to improve mortgage market practices. The series complements RIHA's Working Paper series, which features cutting-edge scholarly research and analysis.

I hope that, through the Institute's work, you will share our enthusiasm for this enterprise. Working together, we can make real progress in expanding housing opportunity for all Americans.

Christopher J. Sumner
President
Mortgage Bankers Association Of America

EXECUTIVE SUMMARY: THE INSTITUTE PERSPECTIVE



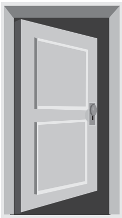
The mortgage industry's investment in homeowner education and counseling (HEC) has dramatically increased over the last decade. But there is no systematic body of research that convincingly demonstrates that homebuyers receiving counseling, education, or training are less likely to default on their mortgages.

A potential resolution of this contradiction emerges when one considers the various roles played by HEC in the home buying process. HEC providers simultaneously meet several mortgage industry needs. They can:

- provide low cost information and consumer outreach in nontraditional markets for lenders and secondary market agencies
- reach a new client base by crossing cultural and linguistic barriers as well by building community trust in the mortgage market and lenders
- help mortgage lenders satisfy CRA requirements and GSEs meet their affordable lending goals
- sort through potential homebuyers to find creditworthy households and send mortgage-ready applications to lenders

These functions of the HEC industry may explain the phenomenal growth of HEC activities. But, to secure funding that can sustain the industry over the long haul, the value proposition of HEC in reducing default and closure costs must be clearly and convincingly demonstrated.

INTRODUCTION



The Clinton administration acknowledged the critical role of homeownership to the welfare of both families and communities in the National Homeownership Strategy (1995) by establishing the goal of raising the national homeownership rate to 67.5 percent by the year 2001. The increase seems negligible; after all, homeownership rates were at 66.6 percent at the end of 1999's second quarter, according to the Bureau of the Census. However, homeownership rates vary dramatically across population groups. For example, homeownership rates of minorities are significantly lower than those of whites. While 69.1 percent of households headed by whites owned their homes in 1996, only 44.1 percent of households headed by African Americans and 42.7 percent of households headed by Hispanics owned homes (Callis 1997).

Homeownership rates vary across geographic areas as well as between ethnic groups. In 1999, 50.1 percent of households living in central cities owned their homes compared with 73.7 percent of households living in the suburbs. Households with younger heads (39.1 percent for households with heads less than 35 years old), recent immigrants (33.1 percent for noncitizens), and lower income households all have lower ownership rates than the population as a whole. Together, these population groups with historically low homeownership rates have been designated as "underserved" by policymakers.

Almost all affordable lending initiatives include homeownership education and counseling (HEC) as a fundamental component of their strategies.

While raising ownership rates by slightly less than 1 percent might seem a trivial goal, it will not be accomplished by continuing or expanding what has been already done. The extremely high ownership rates of middle- and upper-income households leave little room for improvement with these groups. Indeed, given that most of these households can easily choose to own, it is likely that ownership rates have reached the saturation point in these markets. Therefore, reaching the higher homeownership goal for the population as a whole will require extending homeownership to underserved populations. The ability to expand homeownership rates through reaching underserved populations is dramatic. Eggers and Burke (1996) estimate that if all income barriers to homeownership were removed, the national homeownership rate would rise to 83 percent.

Homeownership among Americans has been encouraged and supported by a variety of federal programs and policies. Historically, the federal tax code has provided generous tax benefits to homeowners though the deduction given for mortgage interest payments. In addition, a variety of Federal Housing Administration (FHA) programs have expanded access to and provided below-market interest rate mortgage loans for millions of Americans. Several other national initiatives like the Neighborhood Reinvestment Corporation's (NRC) Campaign for Homeownership and Fannie Mae's Trillion Dollar Commitment illustrate the depth of the U.S. commitment to increasing homeownership rates. The main policy tools that have been used to increase homeownership in underserved markets are the Community Reinvestment Act (including the Home Mortgage Disclosure Act—HMDA) and the affordable lending goals imposed on the GSEs by the U.S. Department of Housing and Urban Development (HUD). The CRA requires that regulated mortgage originators conduct a significant portion of their lending activities in designated "service areas" while the "affordable goals" require that the GSEs purchase a large proportion of loans made to the underserved markets.

Helping underserved populations buy homes has been accomplished through more aggressive outreach and the development of special mortgage products. These products boost homeownership by relaxing underwriting guidelines, but they are considered riskier for both borrowers and lenders.[1] Almost all affordable lending initiatives include homeownership education and counseling (HEC) as a fundamental component of their strategies. HEC is seen as instrumental both in terms of expanding or accelerating the market by reaching new homeowners in underserved communities and in terms of stabilizing the market by helping homebuyers stay in their homes (by minimizing default risks over time).

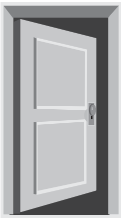
HEC programs have developed successful outreach methods to market homeownership to underserved communities. They have also succeeded in making the home purchase process less daunting for families—filling in informational gaps, allaying fears, and often helping families who fall short of mortgage qualification standards to address and repair their shortcomings.

The growth of HEC in the United States is a good example of a successful public-private partnership. HEC got its start as part of the original legislation that created the U.S. Department of Housing and Urban Development. With some financial support from HUD, and through the creative efforts of nonprofit housing programs, HEC pilot programs were established and generated a history of success—albeit anecdotal—at expanding and stabilizing homeownership for underserved households. Through its thirty-year history, HEC has expanded from a handful of pilot programs to thousands, providing a wide range of education and counseling services.

HEC has received almost unanimous support from stakeholders in the housing and housing finance communities and, as was stated earlier, is commonly required by special homeownership programs offered through lenders. However, there is little tangible evidence that HEC works to expand or stabilize homeownership (Quercia and Wachter 1996). One reason for the dearth of good empirical evidence on the efficacy of the HEC industry is the high degree of diversity among programs. The industry is fragmented due to a large variety of HEC providers offering qualitatively and quantitatively different homeownership training. The unregulated evolution of the HEC industry, while promoting experimentation and creative approaches to expanding homeownership, has made it difficult to evaluate its effectiveness.

As a first step, the goal of this paper is to describe the evolution and current state of the HEC industry. In the following sections, a brief history and an overview of the diversity of the HEC industry are presented. Next, a recent development, the establishment of the American Homeowner Education and Counseling Institute (AHECI), is described. The focus on AHECI is due to the fact that this organization has the potential to greatly affect the future of the HEC industry. This potential impact comes from the market power of the industry players supporting the institute. In the last section, some final remarks are advanced concerning the current state and the future of the HEC industry.

EVOLUTION OF THE HEC INDUSTRY



Two aspects of the HEC industry's evolution are presented in the following section: a short legislative history and a discussion of the growth in the number and type of HEC providers that led to the diversity of the HEC industry today.

Legislation

Homeownership education and counseling (HEC) saw its genesis in 1968 as a result of urban renewal initiatives undertaken by the Johnson administration. A "housing counseling" program was included in the Housing and Urban Development Act (HUDA) that established HUD. This action coincided with episodes of severe urban unrest, the passage of the National Fair Housing Act, and the report of the National Advisory Commission on Civil Disorders. Whitney Young, a member of the commission and head of the Urban League, was the main advocate for the provision of homeowner counseling in the HUDA.

For the first two decades, HEC efforts were dominated by postpurchase programs as a response to widespread defaults in HUD's Section 235 program and the subsequent lawsuits undertaken by assisted households suffering through foreclosures. In 1972, HUD provided funds for demonstration default-prevention programs and developed the Home Mortgage Assignment Program. In this program, lenders would transfer servicing of long-term delinquent mortgages to HUD, which would allow homeowners to keep their homes if they engaged in a workout plan with the assistance of a counseling agency. At around the same time (1971), HUD began certification of counseling programs through Section 106 legislation.

Most industry experts attribute lender's support of (and interest in) HEC to CRA enforcement.

In 1974, Section 801 of the Housing and Community Development Act authorized HUD to directly fund HEC programs. Regular appropriations began in 1977 when $3 million was set aside to establish counseling agencies.[2] Appropriations have risen through the years and exceeded $12 million in the 1990s. HUD provided direct support for more than 300 agencies from 1988 to 1993. Its current list of approved programs numbers over 1,200. By 1993, more than 1,000 agencies received funding from foundations, HUD, and the states. In 1997, HUD distributed $12.3 million in housing counseling grants. The bulk of the grants ($7.8 million) went to 350 individual HEC providers around the nation. About one-third of the funds were distributed to five national umbrella organizations: Association of Community Organizations for Reform Now (ACORN), National Association of Housing, National Foundation for Consumer Credit, Neighborhood Reinvestment Corporation, and Catholic Charities USA. HUD budgeted $18 million to support HEC in 1999.

In 1977, the Community Reinvestment Act (CRA) was passed. The CRA mandates that regulated lenders do regular business in their "service areas." Although the CRA was passed in 1977, with the concomitant Home Mortgage Disclosure Act that required lenders to make their lending practices public, it was not taken seriously by lenders until it was amended in 1989. This was a watershed year for HEC, because it marks the change in orientation from postpurchase default prevention to prepurchase homeownership education.

Since 1992, HUD has established lending mandates that require the GSEs to target a large proportion of their activities to underserved areas.

Most industry experts attribute lenders' support of (and interest in) HEC to CRA enforcement. The CRA spurred lenders' support of HEC in several ways. First, CRA compliance was determined using three broad criteria: lending performance, investment activity; and community service. Community service was the easiest criterion to meet. Community service "brownie points" could be earned immediately by supporting community-based organizations (CBOs). CBOs usually provided the impetus for regulators to scrutinize lenders' activities—often marshaling HMDA data to support their claims. Affordable lending partnerships between lenders and CBOs assuaged this adversarial relationship. Consequently, lenders increased finanacial support of HEC noticeably, beginning in the early 1990s.

Lenders still needed to reach underserved markets to fulfill the performance goals. Without much lending experience in underserved markets, lenders had little information to guide their lending activities. They risked making large numbers of unprofitable loans to comply with the CRA.

Further, because HMDA publicized their lending activities, lenders risked bad publicity if they used mortgage denials to sort out creditworthy borrowers from underserved populations. HEC agencies provided a valuable service for lenders because they assembled information about potential customers in these markets. Further, HEC provided a low-cost marketing strategy. HEC agencies absorbed the responsibility of outreach while sorting through underserved populations for creditworthy households. While evidence is entirely anecdotal, successful partnerships between lenders and CBOs showed that affordable lending could be done profitably.

The collapse of the savings and loan industry in the 1980s and the credit crunch in the early 1990s led to a resurgence of interest in HEC at state and local levels. Highly volatile urban housing markets, the collapse of rural markets, and the rise in homelessness led many to worry about the American tradition of historically rising homeownership rates. This worry was accompanied by a measurable decline in homeownership rates and widespread concern about housing affordability for middle- and lower-middle-class households. Since that time, many public and private efforts to increase homeownership feature HEC as a main component. During the early 1990s, many state housing finance agencies and city governments developed affordable housing strategies—supporting homeownership using down payment grants, soft and silent second mortgages, and mortgages underwritten at below-market interest rates.

Another watershed legislative event was the 1992 Federal Housing Enterprise Financial Safety and Soundness Act. This act allowed HUD to set affordable housing goals for the government-sponsored enterprises, Freddie Mac and Fannie Mae. Since 1992, HUD has established lending mandates that require the GSEs to target a large proportion of their activities to underserved areas. These goals are not trivial. For example, the lending goals set for 1996–1999 require that 42 percent of the loans the GSEs purchase serve low- and moderate-income households.[3] An additional 24 percent of the loans they purchase must come from underserved markets.[4] The GSEs require HEC as a condition for consumers to take advantage of all the affordable loan products developed to meet these goals. As before, HEC

Because the GSEs require people to take counseling in order to qualify for these mortgages, the HEC providers became useful marketers of the mortgages.

provides a low-cost mechanism for targeting and screening potential borrowers to meet these goals.

Government legislative and financial support for HEC through the promotion of low-income homeownership has a long history, and HUD has played a leading role in the proliferation of HEC. In 1999, HUD directly distributed $18 million to housing counseling agencies as part of its Section 106 authorization.[5] HUD allocated $5 million to go directly to HUD-approved housing counseling agencies, $6 million to multistate intermediaries (umbrella organizations), and $7 million to state housing finance agencies.

There is no national standard for homeownership education counseling certification. HUD does certify HEC providers, however, and there are benefits for agencies that become HUD certified. First, certification allows the agency to receive training and technical assistance from HUD. Second, the agency becomes eligible to compete for grants. HUD funds are distributed competitively. Applications from housing counseling agencies are rated according to four criteria: 1) the capacity of the organization to fulfill the goals expressed in its application; 2) the extent of the housing problem addressed by the counseling agency; 3) the soundness of the counseling approach; and 4) the ability to leverage other funding once the HUD funding is in place. HUD has historically provided the bulk of ongoing financial support for HEC programs. It has never been HUD's intention to cover all HEC costs, but rather to help establish programs so that they can attract other sources of funding.

The Growth of HEC Providers

Government agencies usually partner with local nonprofits to provide outreach, homeownership education, and postpurchase counseling. An almost universal eligibility criterion for households receiving state and local support is completion of homeownership education with a certified provider. For example, the Washington Housing Finance Authority partnered with Seattle HomeSight to provide homeownership education for homebuyers receiving affordable mortgages in targeted neighborhoods in Seattle. HomeSight contracts with the city of Seattle to develop affordable housing and provide HEC for households buying city-subsidized housing.

In states without extensive nonprofit activities, state and local housing agencies instituted their own HEC programs. For example, because of low population densities, the Alaska Housing Finance Corporation developed its own HEC program that includes a mobile teaching unit to offer HEC in outlying areas. Many rural homeownership programs operate under the aegis of the Rural Housing Services (RHS), the U.S. Department of Agriculture. These include self-help housing, direct loans for homeownership, and an array of other housing support services. RHS has a homeownership education requirement for homebuyers in its programs. The training is often administered by multifunction rural nonprofit agencies, by the state and rural development offices, or through partnership with state cooperative extension offices working through land grant colleges.

Since 1992, the GSEs developed a strong interest in the value of HEC both for marketing purposes to reach the HUD lending goals and for default risk minimization. The GSEs do not underwrite mortgages directly. Because HUD requires (through the Federal Housing Enterprise Financial Safety and Soundness Act) the GSEs to purchase an increasing share of loans originated in underserved neighborhoods or with low- or moderate-income homebuyers, they need to expand activity in these markets. Expanded activity is accomplished through the development of special affordable products with relaxed underwriting guidelines. Because the GSEs require people to take counseling in order to qualify for these mortgages, the HEC providers became useful marketers of the mortgages.[6]

As the HEC industry continues to grow, new techniques for a more efficient implementation of HEC are originating, albeit not without controversy. In 1991–92, over-the-telephone HEC was implemented on a large scale by Countrywide Mortgage and GE Capital. Workbooks were mailed to potential homebuyers who were subsequently quizzed over the telephone to determine their command of the material. In 1994, Fannie Mae began requiring borrowers to complete a certified HEC program as a standard for their purchase of particular affordable products. In the same year, GE Capital persuaded Fannie Mae to accept its telephone-based counseling (tele-HEC) as satisfying this HEC requirement. This acceptance opened the door for the recent proliferation of over-the-telephone HEC providers.

It is noteworthy that the vast majority of loan applicants seeking tele-HEC have already signed purchase and sales (P&S) agreements (more than 80 percent, according to our respondents).

It is noteworthy that the vast majority of loan applicants seeking tele-HEC have already signed purchase and sales (P&S) agreements (more than 80 percent, according to our respondents). They are seeking HEC solely because it is an eligibility requirement for GSE affordable mortgage products or other housing assistance. Today, all the largest providers of HEC use over-the-telephone methods. GE Capital, Countrywide, Mortgage Guaranty Insurance Corporation, and the Republic Mortgage Insurance Company each claim to counsel more than 250 households per month. This exceeds the yearly output (number of counseled individuals) of many local programs that offer strictly face-to-face counseling and education.

The proliferation of telephone-based HEC may well be the most important recent development in HEC's evolution in the United States. It is noteworthy that all representatives of corporations offering tele-HEC contacted for this study expressed concern regarding the value of these programs, especially with regard to reducing default risk.

The Diversity of the HEC Industry

The HEC industry developed in a rather haphazard fashion. Its development responded to market forces, political expedience, and the creative efforts of local advocates. Most early HEC efforts received critical, but limited, funding from HUD to get established. Most of the programs that signed on to provide counseling were originally designed to respond to specific local housing issues.

Early HEC efforts tried to address foreclosure prevention rather than prepurchase education. The stagnation of homeownership rates in the 1980s moved the industry into homeownership education and marketing. More recently, HEC programs have focused more effort on sustaining homeownership through postpurchase counseling and education programs. Today, the archetypal HEC program promotes full-cycle services, attending to both the homeownership education needs of its clients and offering postpurchase support, including foreclosure prevention.

With limited funding trickling down and local housing issues dominating the efforts of HEC providers, a wide variety of HEC approaches emerged. Most HEC providers developed their own curriculums and educational materials. Programs differed according to the topics covered, the breadth and depth of instruction, and the specific goals of the HEC providers.

This industry fragmentation confounded early efforts to study the efficacy of HEC. The lack of comparability between programs made it difficult to measure program success empirically. Further, individual programs evolved rapidly, making it difficult to assess the results of a single program at different points in time. As the industry matures, however, the high variation between program methods and their quality is disappearing. Programs are adopting more uniform methods. Nonetheless, significant variation still exists. The diversity across programs with regard to services provided is summarized in table 1.

Progress toward uniformity has been hastened by attempts to establish minimum curricular and certification standards by HUD and NRC and most recently the industry-sponsored American Homeownership Education and Counseling Institute (AHECI). As the industry has matured, stakeholders' interests and goals have evolved as well. Lenders report that CRA scrutiny now focuses more attention on lending activity and less on community service. Further, as lenders gain more experience in affordable lending, the knowledge that it can be done profitably has increased interest in fine-tuning HEC efforts. Many large lenders have decided to provide HEC training in-house so that they can design the curriculum to suit their interests and keep their HEC graduates as borrowers. Industry stakeholders will no longer accept anecdotal information to validate claims that HEC works. They want to determine whether HEC actually reduces default risk. They want to know which outreach and training methods work best, and why.

To this end, several recent research initiatives have been commissioned, including important research contracted through AHECI. Industry watchers are eagerly awaiting the results of the AHECI research, which will be released soon.

Table 1. Services Provided by HEC Agencies

HEC agencies offer a wide array of services. The typical prepurchase counseling program will usually do the following:

- outreach and market homeownership program
- assess a family's ability to purchase a home based on income and credit history;
- help to repair, or to establish, credit histories for those with bad or no credit;
- monitor household income and expenditure;
- advise and assist clients in finding employment opportunities to increase inadequate incomes;
- review all aspects of the purchase and the financing of a home;
- link clients with lenders, real estate agents, and social service agencies.

Some HEC providers offer other services, including the following:

- down payment assistance;
- favorable mortgage terms through affiliated lenders or their own underwriting services;
- screening for admission to federal, state, or local homebuyer subsidies;
- forbearance from lenders if the client has trouble making mortgage payments;
- postpurchase counseling to assist in money management, home maintenance, or workout schemes to prevent foreclosure.

Some HEC agencies are multifunction organizations that include HEC as one part of a comprehensive low-income homeownership or community development strategy. Other programs in which HEC agencies often engage include the following:

- affordable housing development and production;
- rehabilitation and sale of the existing housing stock;
- mortgage (first or second) underwriting;
- development and/or management of low-income rental property;
- small business development;
- organizing community programs—child care, neighborhood gardens, neighborhood watch, sports leagues, etc.

CURRENT STATE OF THE INDUSTRY

The diversity and fragmentation that characterize the HEC industry is described in this section. Three aspects are described in detail: taxonomy of HEC programs, linkages between HEC providers and other agencies/organizations, and the activities of HEC agencies. With regard to activities, several are described in detail, including outreach mechanisms and educational materials used, clientele served, barriers to home purchase of targeted clientele, and the strategies employed to address these barriers.

Taxonomy of HEC Programs

There are four types of homeownership counseling: homeownership education, prepurchase counseling, postpurchase counseling, and foreclosure prevention. These four types of counseling differ with regard to cost, curriculum, instructional methods, intensity, and where in the homeownership process the homebuyer engages in counseling. Table 2 illustrates the types of counseling and education HEC agencies usually offer.

It is important to distinguish between prepurchase homeownership counseling and prepurchase education. Education is general in nature and helps households determine whether homeownership is right for them. Education may include the provision of brochures, classroom-type seminars, and other such activities. Homeownership education is usually conducted in group settings and covers such topics as determining how much housing a client can afford; selecting a Realtor; selecting a home; understanding housing finance and the closing process; recognizing the importance of maintenance and repairs after home purchase; and knowing how to avoid default or foreclosure.

Prepurchase counseling includes both general education and more intensive one-on-one counseling. This type of counseling is more rigorous. It takes place over a longer period and often includes assistance in the following: establishing and improving creditworthiness; setting and achieving income goals; setting and achieving savings goals to finance down payment and closing costs; and finding and qualifying for assistance from lenders and local programs, in addition to providing the educational materials mentioned above. Prepurchase homeownership counseling is almost always face-to-face and can include direct intervention in the lives of homebuyers. It is considerably more time intensive and expensive to provide than homeownership education.

Table 2. Taxonomy of HEC Programs
Homeownership Education and Counseling

Prepurchase		Postpurchase	
Education*	**Counseling**	**Counseling**	**Foreclosure Prevention**
Instruction regarding the process of finding, purchasing, and financing a home	Resolution of barriers to homeownership	Ongoing instruction in ways to make homeownership sustainable	Crisis intervention to assist borrowers already in deep trouble
Acts as a marketing and screening device for lenders, often done in classes, over the phone, and rarely one-on-one	Usually involves repairing credit or work history problems—turning sub-prime candidates into A or A- borrowers	Usually includes instruction in housing inspection and maintenance, budgeting, and crisis prevention	Often kicks in after long delinquency
Often done in unison with counseling or as screening for counseling	Typically done one-on-one, sometimes supported by group classes	Sometimes involves active monitoring of household behavior by provider	Provider acts as both counselor and intermediary between borrower and lender
A requirement for many affordable lending programs	Usually integrated with postpurchase counseling efforts	Typically conducted in classes with some one-on-one visits to homes by providers	Has the longest history of all programs
Largest programs use over-the-telephone methods	Often a long, intensive process—can take three to five years	Very few programs in operation	Often requires costly support for borrowers
Least costly of all programs and has the best-developed educational materials	Is labor intensive and costly	Provided by nonprofits—particularly those who act as developers or underwrite second mortgages	Can be time intensive and costly
Provided by nonprofits, government agencies, and for-profits: lenders, Realtors, mortgage insurance companies	Most often provided by nonprofits		Provided by both for-profits and nonprofits

* A more extensive explication of homeownership education is presented in the discussion of national curricular standards suggested by AHECI.

Counseling providers can, and often do, screen clients to determine whether they are ready or able to purchase a home. For example, Seattle HomeSight will not allow a client to purchase one of its homes without a minimum of one-year continuous clean credit. Chattanooga Neighborhood Enterprise will not allow a household into its Fastrak to Homeownership program if they cannot prove they have saved the equivalent of a 2 percent down payment for a home. The Salisbury (Maryland) Neighborhood Housing Services uses prequalification on the first visit to determine which education and counseling services a client will require. Many counseling agencies have begun using credit scores to screen households into various levels of services.

HEC agencies often serve larger goals, in addition to the goal of expanding the homeownership market, to those traditionally excluded from this market.

Depending on local conditions, particularly the configuration and condition of the housing stock, prepurchase programs sometimes offer landlord training modules and instruction in rehabilitation and renovation.

Some of the largest providers of prepurchase HEC educate clients over the telephone (tele-HEC). In these programs, workbooks are sent to potential homebuyers. The clients are provided a toll-free telephone number to contact a homeownership educator if they have questions regarding workbook exercises. After the clients have completed the workbook assignments to their own satisfaction, they agree to be quizzed by a representative of the HEC provider. If a client passes the quiz, he or she receives a counseling certificate through the mail. Most tele-HEC providers are quite large, educating 200–300 clients per month. A large majority of their clients have already signed purchase and sale agreements.

Although the first housing counseling programs were postpurchase foreclosure-prevention programs, postpurchase counseling programs are far less prominent than prepurchase programs today. Two main types of postpurchase HEC offered are the following: default-prevention counseling, designed to assist borrowers with mortgage repayment problems; and, postpurchase education programs that cover topics such as home maintenance skills, senior annuity (reverse) mortgages, and budgeting. Foreclosure prevention usually includes financial planning and assistance in developing a debt workout plan acceptable to both lender and borrower. A major component of default-prevention counseling is the mediating role the counselor plays. Often, the agreement to participate in default-prevention counseling is enough to gain forbearance from a lender.[7]

There has been recent renewed interest in postpurchase counseling and education programs. For the most part, established HEC providers are adding new postpurchase programs to their prepurchase efforts. This movement toward full-cycle homeownership assistance is an industry response to concerns about the sustainability of homeownership for traditionally underserved homeowners. NRC has been the most prominent advocate of the full-cycle approach, establishing Full-Cycle Lending as part of its Campaign for Homeownership.

The Role of HEC Providers in the Creation of Linkages

HEC agencies often serve larger goals, in addition to the goal of expanding the homeownership market, to those traditionally excluded from this market. HEC providers forge a variety of different levels of linkages. These links can include anything from working with the community and potential homebuyers, to links to other local agencies, links to state agencies and federal agencies, and links to the private sector.

HEC agencies often perform the critical, and often overlooked, job of streamlining local housing policies. HEC agencies help to identify administrative inefficiencies and antiquated regulatory barriers. For example, the New Britain, Connecticut, Neighborhood Housing Services (NHS) is leading a statewide effort to make building and fire codes consistent and consistently enforced. NHS had encountered significant problems rehabilitating multifamily owner-occupied housing because of insurmountable administrative barriers, mostly due to inconsistencies in the codes and their enforcement.

Linkages with other organizations improve the services individual counseling providers give. There are two important types of linkages: those that connect clients (program participants) with other services, and affiliations of the agency itself with other organizations. The two categories are not mutually exclusive. For example, a counseling provider will have better access to information and be able to link clients to HUD-sponsored programs more effectively if it is a HUD-approved counseling agency. Further, agencies like the Neighborhood Housing Services and the Association of Community Organizations for Reform Now (ACORN) share educational or informational resources with their affiliates.

Sometimes linkages work against clients. For example, an agency that is formally linked to a neighborhood development agency might be limited in geographic scope regarding where it can place its clients. Homeowners counseled by Home Ownership Center agencies in Minneapolis–St. Paul cannot take advantage of special lending programs if they purchase outside of specific city neighborhoods. Financial support in the form of down payment assistance or second mortgages is not available for those who choose to buy in the suburbs. This situation arises because some lenders' programs and affordable housing products are restricted to specific geographic locations to meet CRA guidelines.

Linkages can be manifold and complicated. Counseling providers might be affiliated with several national organizations, a regional organization, multiple state organizations, and several local services. The support options offered to clients might differ dramatically depending on which agency provides support and the jurisdiction within which a desired home falls. Sometimes a main feature of the counseling service is to unravel the various support options to enable households to make the best-informed choice.

About 64 percent of all the HEC providers contacted for this study are linked to local governmental programs—usually at the state, county, or city level. All nonprofit providers contacted (100 percent) have a national affiliation—either with HUD, Fannie Mae, and/or national umbrella agencies like NHS or ACORN. Finally, about 73 percent of all providers contacted have developed partnerships with local lenders—usually providing HEC for borrowers who apply for special lender products.

A Look at HEC Providers

Counseling providers can also be divided into those that offer training for others who will provide education or counseling and those that only offer counseling services directly to potential homebuyers. For the purpose of this report, the former are designated as "umbrella" agencies. These agencies develop a curriculum, produce and circulate educational materials, and train counselors who then work with local community development agencies to provide direct counseling. Often, umbrella agencies act as direct providers of counseling services while they train others.

Sometimes, umbrella agencies act as clearinghouses for information and data collection. Three major umbrella agencies are the Neighborhood Housing Services, ACORN, and the Cornell Cooperative Extension. These agencies provide materials and training for counselors who work at the local or state level. The NHS and ACORN act as rather loose umbrellas over a large and diverse set of urban-based providers of homeownership counseling (and a variety of other community services). The Cornell Cooperative Extension provides materials and training for other state cooperative extensions as well as hundreds of direct counseling agencies in New York. The Cornell Cooperative Extension services generally target rural areas.

Some counseling programs have duplicated themselves in other locations. A good example of this type of expansion is the Twin Cities Mortgage Foreclosure Prevention Program. The main funder of this program, the Northwest Area Foundation, funded replications of the program in Oregon, Idaho, and Iowa. The Twin Cities' program staff helped provide training and technical support for counselors at those sites.

Some counseling providers are strictly local, direct providers. These agencies generally arise in response to local demand for services. Often, they work closely with lenders and other community development organizations with homeownership programs. For example, the Durham Affordable Housing Coalition (DAHC) in Durham, North Carolina, began a counseling program to support a variety of affordable housing initiatives already undertaken by the organization.

About 42 percent of clients participating in HEC programs are single head of households, and more than 93 percent of these are female.

The sample of HEC providers contacted for this study provides a snapshot of the agencies. It is important to keep in mind that the sample of HEC providers contacted was not a random selection, so it is not advisable to draw inferences from this sample to the national HEC industry.

Average HEC Provider. The average HEC provider has been in operation for more than eighteen years and has provided counseling for more than five years. Most providers are nonprofit, although those operating through cooperative extensions and rural development programs are quasi-governmental organizations. In 1998, 490 households approached the average provider for HEC. (Among all providers, the number ranged from a low of 58 to a high of 3,500 households.) The average HEC provider offers nine hours of classroom time in education programs and 2.5 hours of one-on-one counseling (not counting tele-HEC).

Educational Materials. Typically, HEC providers rely on four educational materials. Many use more than one standardized curriculum to support their efforts. Most use Fannie Mae's workbooks and other educational materials (62 percent of providers). About one in three providers uses the materials developed by the Mortgage Bankers Association of America (36 percent of providers). About one in four uses HUD-provided materials and the Fastrak to Homeownership materials developed by Chattanooga Neighborhood Enterprises (27 percent). Most providers have developed their own curriculums (56 percent), often used to complement one or more of the other materials.

Outreach. Most HEC providers rely on referrals from friends, lenders, government agencies, or Realtors to attract clients to the program. About 82 percent of HEC providers listed "word of mouth" or "referrals" as the most effective outreach mechanism. HEC providers target both geographic locations and/or specific households for service. For instance, more than half of the agencies contacted target households with incomes at or below 80 percent of the HUD-adjusted local area median income.

Overall, the typical HEC provider has a 67 percent graduation rate and a 25-40 percent home purchase rate for graduates.

Clientele. HEC providers in urban areas serve younger and smaller families than providers in rural areas.[8] About 42 percent of clients participating in HEC programs are single head of households, and more than 93 percent of these are female. Most agencies serve predominantly one racial/ethnic group (84 percent of providers). Less than half serve mostly white clients (44 percent).

About half of all providers screen clients prior to offering counseling (48 percent). Some providers (18 percent) do not provide counseling to households that, because of their circumstances, have little chance of purchasing within a specified time, say six months. These difficult households are referred to other agencies for assistance. Most providers, however, serve all households and screen clients to determine the best service track for them.

Households approach HEC providers at different stages of the homebuying process. In 1998, about one in four households had already signed purchase and sales agreements before approaching a HEC provider (24 percent). For the majority of HEC providers, less than 10 percent of those counseled had signed purchase and sales agreements prior to contact. In contrast, several very large HEC providers reported that more than 70 percent of counselees had signed purchase and sales agreements before approaching the program. Typically, these providers offered over-the-telephone services.

Overall, the typical HEC provider has a 67 percent graduation rate and a 25–40 percent home purchase rate for graduates. Most of those who purchase a home do so within a year of completing the HEC program (71 percent). About one in ten purchases homes within two years (9 percent). For the typical HEC provider, delinquency rates for counseling graduates who purchased homes average 6–10 percent, and default rates average less than 1 percent.[9]

In 1998, the average HEC provider made an $8,000 soft second mortgage to address affordabilty barriers. Second mortgages ranged from a low $1,000 to a high of $120,000.

About half of the providers contacted charge a fee for providing counseling and education services to targeted populations (48 percent). The average fee is $25, although fees range from a low of $20 to a high of $145.

Barriers to Homeownership. HEC providers cited affordability and credit problems as the major barriers to homeownership among the households served. In decreasing order of importance, HEC providers identified the following barriers: credit problems (100 percent of providers); lack of savings for down payment and closing costs (93 percent); affordability problems (high prices, low income) (77 percent); lack of knowledge regarding the home purchase process (73 percent); cultural/linguistic barriers (63 percent); lack of knowledge regarding available housing support (57 percent); unavailability of decent housing (23 percent); and high construction costs (19 percent).

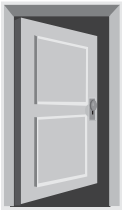
Obviously, the specific barriers a given HEC provider confronts depend on where the provider operates. For instance, providers in areas with robust housing markets (e.g., growing areas of the Southwest, South, Boston, New York, Washington, D.C.) were most likely to list affordability and housing supply as major barriers to homeownership. Agencies in declining and/or rural markets most often listed affordability (insufficient income) and lack of quality housing stock as major barriers to homeownership.

Strategies Employed. HEC providers offered a number of services to assist potential homebuyers. In addition to HEC itself, many providers said they offer services to help households address wealth and affordability barriers. Almost all providers offer education, counseling, and assistance in the areas of budget planning and fiscal discipline (100 percent of providers); and demystification of the home purchase process (96 percent). In addition, more than three of every four providers also offer assistance with credit building and repair (79 percent). In contrast, only about half provide financial assistance to address problems of insufficient savings to meet down payment and closing costs (57 percent)[10] and/or insufficient income to meet monthly payments (47 percent). This type of assistance can take the form of forgivable or deferred payment second mortgages with special terms. In 1998, the average HEC provider made an $8,000 soft second mortgage to address affordability barriers. Second mortgages ranged from a low of $1,000 to a high of $120,000.

...to bring together a comprehensive group of industry stakeholders to establish both national curricular guidelines and certification standards.

The presentation in this section shows a fragmented and diverse HEC industry. The fragmented and diverse nature of the industry, along with its unregulated evolution (described earlier), has left many stakeholders in the U.S. housing industry worried about the quality of services delivered by HEC agencies. Although HUD and NRC established certification guidelines, many quality HEC providers fall outside of the HUD and NRC umbrellas. The next section describes a recent development that has the potential to address these concerns.[11]

AMERICAN HOMEOWNERSHIP EDUCATION AND COUNSELING INSTITUTE



Fannie Mae initiated the American Homeowner Education and Counseling Institute (AHECI) in 1996. It was Fannie's hope to bring together a comprehensive group of industry stakeholders to establish both national curricular guidelines and certification standards. Fannie invited other GSEs, large lenders, mortgage insurers, Realtors, and national housing nonprofits to participate in the effort.

The following organizations are the original founding members of AHECI:

- ACORN Housing Corporation
- America's Community Bankers
- Chase Manhattan Bank
- Citicorp Foundation
- Countrywide Home Loans, Inc.
- Fannie Mae
- Fannie Mae Foundation
- First Commerce Community Development Corporation, New Orleans
- Freddie Mac
- GE Capital Mortgage Insurance Corporation
- GMAC Mortgage
- Home Ownership Center, Minneapolis-St. Paul
- Mississippi Home Corporation, Jackson
- Mortgage Bankers Association of America
- Mortgage Guaranty Insurance Corporation
- Mortgage Insurance Companies of America
- National Association for the Advancement of Colored People (NAACP)
- National Association of Home Builders
- National Association of Real Estate Brokers
- National Association of Realtors
- National Council of La Raza
- National Council of State Housing Agencies
- National Federation of Housing Counselors, Inc.
- National Foundation for Consumer Credit, Inc.
- NationsBank
- National Training and Information Center
- National Urban League, Inc.
- Neighborhood Reinvestment Corporation
- Northwest Counseling Service, Inc., Philadelphia
- Norwest Mortgage, Inc.
- PMI Mortgage Insurance Companies
- Republic Insurance Company
- Sacramento Home Loan Counseling Center

Many of these organizations provided initial financial support to AHECI. For-profit members each put up at least $200,000 of initial funding for the institute, while nonprofits were not required to put up any funds. Several for-profits put up a larger share. Fannie Mae representatives pointed out that both the Fannie Mae Corporation and the Fannie Mae Foundation put up $1 million for a total commitment of $2 million. HUD provided $500,000 of initial funding. Several nonprofits offered their financial assistance for the enterprise, although on a smaller scale than the other industry stakeholders did. At the time of this report, AHECI did not have a source of ongoing funding. Potentially, because of the market power of its founding member organizations, AHECI can have a significant impact on the future of the HEC industry.

AHECI was established to accomplished five goals:

- to establish national accreditation standards for providers of HEC;
- to develop a core curriculum for HEC;
- to research the costs and benefits of HEC;
- to establish the means for self-financing of HEC initiatives;
- to establish an informational clearinghouse for HEC materials and methods.

AHECI assembled five working committees to develop strategies to achieve each goal. Each committee was charged with drafting recommendations. To date, three committees have circulated draft recommendations: the Research Committee, whose draft recommendations were circulated at the end of 1997[12]; the Curriculum and Certification Committees released their draft recommendations in July 1998 for comment. These drafts are currently being revised in response to practitioners' commentary.

In the rest of this section, we present the structure of the curriculum and certification standards and discuss stakeholders' views of the process of producing the documents. We focus on AHECI's curriculum and certification efforts because they address central concerns about the HEC industry, i.e., its fragmented and unregulated nature.

The Draft Curriculum

The draft curriculum is a comprehensive volume presenting a model course structure for HEC providers. It provides significant detail for teaching eleven main course modules. The modules are presented in table 3.

Each module includes detailed lists of topics that instructors should cover in homeownership training. A fairly comprehensive reference list of materials is included with each module as well. It is estimated that at least 10–12 hours of class time will be required to cover the curriculum. Most homeownership training courses currently offered take a little less time than that.

Certification Standards

The Certification Committee released its draft recommendation at the same time as the draft curriculum. In it, the committee presented an outline of certification standards in rather vague terms. Section 2, which discussed the development of standards, lists about three dozen issues that will be addressed by the Certification Committee. These include the following:

- homeowner education from homeowner counseling;
- certification standards that will apply to education and counseling;
- standards for the accreditation of agencies;
- codes of ethics and conduct;
- evaluation of competency;
- decertification and recertification standards; and
- training, testing, and certification methods.

The document lists forty-two “broad consensus” items that were discussed by the committee. They are organized into three sections: training; testing and certification; ethical standards and code of ethics. The committee reached agreement on thirty-three of the items, and nine remain unresolved. Six of the nine fell in the ethical standards category. Noteworthy, for the purposes of this report, are the following broad consensus items:

- a minimum of eight hours of contact time is required for certified education;
- homeownership training will be face-to-face, although alternatives for interactive learning will be explored;
- program participants must be tested before receiving a certificate to determine their readiness for homeownership;
- homeowner educators and counselors must be tested for core competency;
- materials and curriculums must be easily understood and available in multiple languages.

Table 3. AHECI's Draft HEC Curriculum

1. The Basics: Preparing for Homeownership

—What to expect

—Benefits of homeownership

2. The Home-Buying Process

—Renting versus owning

—Considering whether to rent or buy

—Is the buyer ready?

—Time line for and steps involved in homeownership

3. Lifelong Money Management

—Examining spending styles

—Understanding financial conditions

—Developing a budget or spending plan

—Credit management

—Traditional and nontraditional financial services

—Cost of homeownership

—Tax benefits of homeownership

4. Financing a Home

—Who's who in the home financing process

—Understanding the language of lenders

—Many mortgage alternatives

—Choosing the right mortgage

5. Qualifying for a Mortgage

—Borrower qualifications

—The mortgage qualifying process

6. Shopping for a Home

—Legal aspects of homeownership
—Fair housing for everybody
—Real estate professionals
—Shopping carefully and evaluating the potential home
—A safe and healthy home
—Taking the leap and making a purchase offer

7. The Loan Application Process

—Applying for a loan
—The approval process
—If the loan is rejected

8. The Closing Process

—The closing "ceremony"
—Preparing for the closing
—Documents at the closing
—Closing costs
—Settlement or closing agents

9. Life as a Homeowner

—Financial planning
—Home equity
—Taxes

10. Getting to Know, and Taking Care of, the Home

—An owner's manual for the home
—Hiring somebody to do repairs or improvements
—Energy conservation

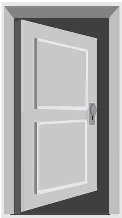
11. How to Prevent Foreclosure

—Surviving a financial crisis
—Communicating with the servicer
—Managing the financial crisis
—The foreclosure process

Members of the Certification Committee who were interviewed for this report noted that the process was far more rancorous than the curriculum development process. The major issue of debate involved who would be certified to provide HEC. Representatives of for-profit and nonprofit groups disagreed about allowing Realtors or lenders to provide HEC. Some representatives considered the conflict of interest to be too large an obstacle for Realtors to provide quality training. Other committee members thought that so long as Realtors and lenders adhered to suggested ethical standards and practiced full disclosure, they should be allowed to offer counseling and education services.

It is noteworthy that AHECI advocates face-to-face education and counseling. This approach is consistent with the views of all but one of the industry experts interviewed for this study. Interestingly, in terms of the raw number of households counseled, the fastest growing segment of the industry is telephone-based HEC, which is the antithesis of face-to-face programs.

REMARKS ABOUT THE FUTURE OF HEC



Homeownership education and counseling, as outlined in this paper, is still a fragmented, diverse, and largely unregulated industry. Four concerns remain central to the future of the industry: certification standards, curriculum contents, financing of HEC activities, and uncertainty about its efficacy. The formation of AHECI is the most promising recent development because AHECI has as its core mission addressing these unresolved concerns. The potential impact of AHECI is magnified by the market power of the organizations supporting it. While it is too early to tell whether AHECI can deliver on its five goals, the review reveals no other recent development that can address these concerns.

The HEC industry has a relatively long history in the United States. It has expanded from just a handful of demonstration programs in the 1960s to several thousand providers that offer a wide array of education and counseling services integrated with low-income housing and community development programs. When part of a comprehensive and aggressive expansion of homeownership opportunities for historically underserved populations, HEC has been embraced uncritically by practitioners, policymakers, and industry stakeholders.

It is astounding to consider what little empirical evidence there is to determine how well HEC works. What is even more surprising is the willingness of industry stakeholders—who carefully consider the risks and benefits of any investment—to commit substantial funding to HEC efforts. For example, Fannie Mae has contributed millions of dollars to support HEC initiatives.

Four observations might help to resolve this contradiction.

1. The amount of money actually committed by industry stakeholders is minuscule compared with the amount of money that passes through the housing finance system. The bulk of the money comes from the public sector, and even the $12 million to $18 million spent annually by HUD is small relative to its budget.
2. It is important to remember that HEC serves at least two roles for industry stakeholders—marketing and risk mitigation. Industry stakeholders are searching for low-cost ways either to achieve CRA

compliance or to satisfy HUD-imposed lending mandates. The small amounts committed by industry stakeholders might represent the lowest-cost marketing strategy.

3. Many industry experts consider the underserved population a combination of three broad groups: the creditworthy underserved who are ready to own; the marginally creditworthy who can be made ready to own; and those who will never own. HEC agencies effectively perform "triage" on the underserved population by sorting it into these groups. Sorting is time consuming and costly. However, if it is done well, lending to underserved populations can be profitable. To increase lending volumes, lenders must penetrate new markets with which they have little experience. They are not equipped to sort out potential clients from the pool of underserved households.
4. HEC done by nonprofits is only a developmental stage for underserved lending. It sets the stage for subprime lending and risk-based pricing by compiling information on markets about which lenders knew very little. HEC efforts by nonprofits will be displaced by the efforts of lenders and other for-profit entities. However, risk-based pricing does not address affordability issues.

The HEC industry's extraordinary growth took place because CRA policies and affordable lending goals pressured lenders and the GSEs to support it. HEC programs evolved to meet the needs of lenders and the GSEs as successful partnerships were formed. For example, because the GSEs do not underwrite mortgages directly, they needed a method to market their affordable products to underserved markets. Making HEC training an eligibility requirement provided a direct marketing mechanism for these instruments—regardless of whether HEC reduced default risk.

Similarly, lenders need to reach underserved markets to meet CRA performance requirements. However, if they try to market loans directly in underserved markets, screening would be done through mortgage denial. Relative denial rates are reported as part of HMDA, and high denials for underserved populations make lenders vulnerable to accusations of disparate treatment. For example, in the early 1990s the city of Milwaukee led the nation in relative denial rates by race. This greatly concerned lenders, regulators, and city officials. The mayor's office called together a consortium of lenders, CBOs, and policymakers to address the issue. Ultimately, forty-two lenders agreed to a program in which they required HEC training as an eligibility requirement for a wide array of affordable mortgage products. Lenders pay HEC trainers a “bounty” of $450 for each mortgage closed through the program. HEC programs agree to make sure that households are “mortgage-ready” at the time of application.

Although the bounty program is relatively uncommon, many HEC programs help to sort households *prior* to mortgage applications. These programs pride themselves in their ability to send mortgage-ready households to lenders. HEC providers help lenders by marketing the lending services, screening households, and reducing denial rates simultaneously. Whether or not HEC reduces default risk, it offers a valuable service for lenders and other market participants.

Several implications emerge from the observation that the HEC industry performs triage on underserved populations. First, HEC agencies can be considered an extra-market mechanism that helps to address a market failure. Specifically, asymmetric information, based largely on the inability of lenders to evaluate default risk of underserved households, leads to a smaller than optimal volume of lending in these markets. Second, the movement toward “fast track” HEC programs reveals a decision to concentrate efforts on the most creditworthy among the underserved—accelerating, rather than expanding homeownership. Ultimately, HEC agencies and lenders will run out of these easy targets for affordable lending. In the future, successful HEC agencies might be those that develop low-cost strategies to expand homeownership to those with low, long term probability of owning a home.

It is important to remember that the main growth of the HEC industry in the United States coincided with an economic expansion of unprecedented duration. The majority of HEC providers have been established since the end of the credit crunch of 1989–91. These providers have operated in a time of robust housing markets, low unemployment, and the increased efforts by lenders to reach underserved markets. Many housing industry experts believe that the efficacy of HEC as a risk-mitigating device has never been put to the test because of the recent unusual market conditions. How well HEC graduates resist default during an economic downturn will be the ultimate test of how well counseling works as a risk-mitigating mechanism. Regardless of HEC’s efficacy to mitigate risk, its popularity may continue to grow because of its ability to reach and extend homeownership opportunities to traditionally underserved populations.

CONCLUDING REMARKS

The homeownership education and counseling industry is, and has been throughout its history, in a state of flux: It is an industry that reacts to fill the gaps between lenders and new markets. While lenders entered so-called underserved markets at the behest of regulatory pressure, history has shown that profitable lending is possible using alternative marketing and lending approaches. The HEC industry was instrumental in bridging the gap between demand for lending services and the supply of these services.

The growth of the industry will be determined by what is learned about its efficacy. Several testable hypotheses emerge from our study. First, while it is true that the growth of the HEC industry occurred with no evidence that HEC training minimized default risk, our narrative suggests that HEC does not have to minimize the default risk of the individual borrower to provide valuable services to the lending industry. Even if HEC recipients have higher default propensities than conventional borrowers, HEC agencies might still be reducing overall default risk by finding the best credit risks among the underserved populations.

To determine whether HEC training reduces default risk, it would be necessary to provide training to two groups of homebuyers who comply with conventional eligibility requirements. One cannot assess the extent to which HEC minimizes default risk for households in underserved markets because one does not have a natural control group—e.g., households in underserved markets who purchase homes without the assistance of HEC training. To determine if HEC affects default risk, it would be necessary to randomly assign households that qualify for conventional mortgages to treatment (HEC training) and control (no HEC training) groups and measure their mortgage performance. Obviously, such a study would need to assume that conventional and affordable borrowers have similar behavioral responses to events that may precipitate the delinquency and default decisions.

The screening and sorting role of HEC can be tested by examining loan denial rates. If HEC agencies effectively sort through underserved markets for mortgage-ready households, then one would also expect to see lower denial rates for HEC recipients. It is not clear whether this can be directly tested using data that is currently available (HMDA, for example), but a test frame could be easily developed to assess the question.

ACKNOWLEDGEMENTS

The authors wish to thank David Metzak of the Canadian Mortgage and Housing Corporation and Devon Idstrom of the University of North Carolina for valuable contributions to the study.

The authors would also like to thank the industry experts who agreed to be interviewed and generously provided their time and expertise to the study. Lowell Yost of the American Homeownership Education and Counseling Institute (AHECI) was particularly helpful with both his insights and his willingness to connect us to other industry experts.

In addition to the Research Institute for Housing America, the data collection and the research reported herein was also supported in part by a grant from the Canadian Mortgage and Housing Corporation.

NOTES

1. Special "affordable" mortgage products relax underwriting criteria in three ways: 1) They require smaller down payments (higher loan-to-value ratios)—some GSE products require only 3 percent down, and products held in portfolio by private lenders include 100 percent LTV products. 2) They allow for nontraditional means for establishing credit histories—these include records of steady payments of utility bills, rent, or other debt not listed on credit reports. 3) They include secondary instruments with special terms to reduce the monthly payment on the first mortgage. These include "soft" and "silent" second mortgages with low or no interest that cover as much as 25 percent of the house price.
2. According to HUD representatives, these funds typically covered about one-third of program costs. HUD expected programs to leverage other funds from local sources once they had secured HUD funding. For programs funded more recently, HUD funds cover about one-quarter of program costs.
3. "Low income" is defined as less than 80 percent of the area median income. Moderate income is between 80 percent and 120 percent of the area median.
4. "Underserved areas" are defined as high minority density (more than 30 percent minority households) or low income (below 80 percent of median) census tracts.

5. A HUD-approved counseling agency can provide homeowner education, counseling, or postpurchase education or counseling. Agencies must be not-for-profit and must offer education and counseling in a face-to-face fashion. In other words, providers of telephone-based education and counseling cannot be approved by HUD.
6. From an interview with a GSE representative.
7. Forbearance usually involves the agreement not to foreclose provided that an agreed-upon workout plan is followed. Lenders might agree to accept interest-only monthly payments for a prescribed period or might even endorse a no- or low-cost refinancing agreement.
8. Almost all providers collect and keep data on counseling participants when they enter the programs (91 percent). However, only 22 percent continue to collect data after purchase.
9. The information on delinquency and default rates was obtained only from HEC providers that track graduates after home purchase and that were willing to share the information with the researchers.
10. It is interesting to note that all HEC programs reported having automated underwriting or automated counseling software at their sites. The majority of the programs had Fannie Mae's Desktop Counselor (58 percent), followed by NeighborWorks 2000 (18 percent); Fannie Mae's Desktop Underwriter (16 percent); and Freddie Mac's Loan Prospector (5 percent). Only one in three agencies reported actually using the software. All expressed the intention of using the software in the future. A more widespread use of automated underwriting may alleviate the problems with closing costs. This is because, typically, automated underwriting is said to reduce closing costs.
11. A second recent development may also affect the HEC industry in a more limited way. To promote homeownership for households in underserved populations and at the same time protect its portfolio risk, the Federal Housing Administration (FHA) adopted a discount plan for qualified mortgagors. FHA offers a reduced rate of 1.75 percent (0.5 percent lower than its standard rate of 2.25 percent) on mortgage insurance for first-time homeowners who graduate from HUD-approved HEC programs. For HUD approval, HEC providers must be nonprofits offering face-to-face HEC in either classes or individual counseling. If they provide classroom instruction, they are required to cover the topics in HUD's Homeowner Education andLearning Program (HELP). In 1998, the FHA expanded its discount program, providing an additional 0.5 percent discount to first-time homebuyers that complete HUD-approved HEC training about

purchasing homes in central cities. This expansion reduces FHA's insurance rate to 1.25 percent. The underlying rationale is based on the belief that homeownership education or counseling significantly reduces default risk. At the time of this study, there is no published evidence regarding the cost-effectiveness of the program.

12. The research committee recommended that AHECI undertake three major research initiatives. The first undertaking is a pilot test of the core curriculum. This began with a demonstration of the curriculum and counseling training to thirty-six practitioners in Stone Mountain, Georgia, in December 1998. It is being followed up with field testing of the core curriculum by HEC providers in thirty states. To date, the results of this research have not been released. The second research initiative is the first comprehensive empirical study of the mortgage performance of households receiving HEC training. Consortium partners agreed to provide microlevel mortgage origination data and servicing records in order to compare the performance of their "affordable" portfolio with the conventional loan portfolio. The study was to be performed in a short time frame with early results to be ready by the end of 1999. The third proposed study is a cost-benefit analysis of HEC training. This analysis is to be a precursor for the efforts of the financing committee to reduce the costs of providing HEC training. Part of the study involves a survey of HEC providers to determine the sources of funding, agency expenses, and how providers and clientele feel about charging fees for HEC services. The goal of the study is to begin to develop means for HEC agencies to become self-financing.

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