NeighborWorks

Neighborhood Reinvestment Corporation

Sustaining Home Ownership Through Education and Counseling

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Fellowship Program for Emerging Leaders
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Neighborhood Reinvestment Corporation

Joint Center for Housing Studies of Harvard University

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ABSTRACT

This paper addresses a two-fold problem. First, some families are struggling to sustain their home ownership, yet market responses are inadequate. Second, postpurchase education and counseling, potential tools to assist vulnerable homeowners, are inadequately provided. This paper presents a conceptual framework for the effect of postpurchase education and counseling in assisting home-owners. It then examines information needs and strategies that can drive the provision of postpurchase services. In particular, the analysis assesses the current effectiveness and implementation of postpurchase programs. It also draws implications from prepurchase counseling and private sector loss mitigation. Finally, current stakeholders in home-ownership outcomes are identified. This paper recommends postpurchase education and counseling that are *integrated* into the lending models of the financial services industry and *comprehensive* over the timeline of the mortgage. A series of models ranging in scope are suggested, including potential actors and challenges involved.

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EXECUTIVE SUMMARY

Home-ownership opportunities for underserved families have skyrocketed. Unfortunately, issues of affordability, mortgage delinquency and home loss have increased alongside these gains. Delinquency and broader sustainability issues have multiple causes. Postpurchase education and counseling can address some of these causes by building relationships with homeowners, addressing a broad scope of underlying issues and facilitating comprehension of the risks, rewards and effort entailed in home ownership. While community organizations are well suited to provide education and counseling, current provision of services for existing homeowners falls short of needs.

Defining Terms: Separating Prevention from Intervention

Home-ownership Sustainability Training offers group or individual education to existing homeowners on topics ranging from home repair and safety to budgeting and tax issues. Sustainability training is usually offered to homeowners regardless of their ability to keep up with mortgage, insurance and property-tax obligations. In contrast, *Delinquency Counseling* specifically targets existing homeowners who are struggling to maintain housing payments. Comprehensive provision of these services would leverage the preventive and relationship-oriented strengths of education and counseling in assisting homeowners. However, current provision tends to separate these services as a result of differences in interests of stakeholders, client entry points and market contexts.

This paper examines the effectiveness, implementation and funding of postpurchase education and counseling. Prepurchase homebuyer education and private loss mitigation are highlighted to draw lessons for community-development practitioners pursuing postpurchase programs. Finally, this paper assesses the interests that various private and public stakeholders have in home-ownership outcomes.

Findings: Home-Ownership Sustainability Training

- Sustainability training programs often measure outputs, but little information is available about the home-ownership outcomes of sustainability training.
- Almost no empirical research has documented the effect of home-ownership sustainability training on borrower delinquency rates.
- The value of sustainability training to the home improvement, insurance and other industries is similarly under-researched.
- Emerging community partnerships with home-improvement retailers and insurance firms provide models of support for postpurchase programs.
- Sustainability training has not succeeded in becoming embedded in referral networks to the same degree as homebuyer education. As a result, many programs report low attendance.
- Most programs rely on grant funding from the philanthropic community, local banks and a few other industries, but a wider set of stakeholders derive value from these home-ownership services.

Findings: Delinquency Counseling

- Existing empirical research on the effectiveness of delinquency counseling is outdated and inconclusive.
- The effects of delinquency counseling are not sufficiently differentiated from the effects of loss-mitigation efforts by loan servicers.

- Housing-counseling agencies report relationships with local lenders, but rarely with large loan servicers. Little voluntary information-sharing occurs between counselors and servicers.
- Intake of borrowers happens late in delinquency, reducing effectiveness and increasing costs for counseling agencies.
- The volume of delinquencies swamps provider capacity. For example, agencies funded by the U.S Department of Housing and Urban Development (HUD) counseled only 150,000 delinquent borrowers nationwide in 2001. This number can be compared to roughly 400,000 homeowners in the foreclosure process at the end of 2002.[1]
- Funding for delinquency counseling is insufficient and inadequately indexed to the costs incurred by local agencies.

Implications for Practitioners and the Financial Industry

This analysis suggests two directions for postpurchase education and counseling. The first is toward the provision of services that are more *integrated* into financial and other markets. Integration into the market can help to illuminate the financial value of education and counseling to specific actors and to drive the provision of effective and accountable models. The second direction is toward more *comprehensive* support for families both before and after home purchase. This will require providers of education and counseling to link the interests of multiple stakeholders into a delivery system that can address multiple homeowner needs. This will also require intake and referral mechanisms that reach families before they are in financial distress.

Two vital actions must accompany efforts to expand postpurchase services. The first is an attempt to build working relationships between community groups and stakeholders, especially private-sector firms such as loan servicers and mortgage insurers. These are the segments of the financial-services industry that have a strong stake in preventing mortgage delinquency, yet few community groups are establishing relationships with these industry actors. A second action is ongoing research and evaluation. The major stakeholders in the mortgage industry will need convincing empirical evidence that postpurchase education and counseling is worth the costs. In addition, education and counseling providers need guidance on the most cost-effective intervention strategies. Through an iterative process, successful pilots can be brought to scale to address major issues facing mortgage lending.

Recommendations

This paper recommends a range of “business model” pilots in order to test the effectiveness of integrated and comprehensive education and counseling:

- Integrated and comprehensive services could be driven by contractual relationships between firms in the loan-servicing industry and single organizations or collaboratives of housing-counseling agencies. Services would include prepurchase counseling, some regular follow-up during the initial year of home ownership, and contact or counseling roles in the event of borrower delinquency. Prerequisites include addressing contract and privacy issues, building counseling capacity and coordinating roles across sectors.
- Less extensive variations on integrated and comprehensive services could include only the provision of postpurchase services through contractual agreement, “one-stops” that address a broad set of homeowner needs and provision of prepurchase education that includes discrete postpurchase components.

[1] Counseled borrowers from HUD form 9902, as reported by Brian Siebenlist, interview, August 7, 2003; estimated foreclosures in Joint Center for Housing Studies (2003).

- For housing-counseling agencies that choose not to collaborate across sectors, delinquency counselors could tailor approaches based on borrower and servicer characteristics. Alternative methods to intensive contact need to be explored when no funding is available. Counseling agencies could rely more on servicer-initiated workouts when the record of the servicer merits this trust.

This paper also recommends several policy changes:

- HUD, national community-development intermediaries and private foundations should increase counseling agency capacity through
  - improved information and technology availability,
  - funding that compensates agencies for volumes and costs, and
  - clarification of HUD conflict-of-interest regulations for agency funding.
- Firms and agencies that have a public-service orientation should examine incentives for loan servicers to determine whether they are effective in inducing servicers to pursue workouts to optimal levels. Appropriate actors would include public and private mortgage insurers, the government-sponsored enterprises (GSEs) and portfolio lenders that maintain a strong community-development focus.
- Expand Community Reinvestment Act (CRA) credit to lenders who pilot and test the effectiveness of innovative education and counseling models. While CRA credit has been given to lenders for grant-making and for loans that include prepurchase components, lenders should be compensated for evaluation and research and for servicing models that incorporate counseling components.

Looking Ahead

The recommendations outlined above must overcome current obstacles. While sometimes warranted, lack of information-sharing and trust between community organizations and loan servicers prevents some beneficial arrangements. Nonprofits can interact with firms differentially based on the practices of the firm. At the same time, business interests will need to pay for the legitimate value provided by nonprofits. Providers of postpurchase programs need to improve quality and consistency and to clarify the added value of these services to homeowners and private industry.

I. INTRODUCTION

This paper explores the question of sustaining home ownership for struggling families through education and counseling. A rising rate of foreclosure suggests that the problem of sustainability is growing. Families with low or unstable incomes, low cash reserves and little experience with financial institutions are more vulnerable to economic events and market actors that threaten their ability to maintain mortgage payments and meet essential needs. A slow or sudden downturn in the financial position of the family then can lead to mortgage default and possibly to foreclosure. One major market response to the higher expected risks facing vulnerable families is an increase in the fees and interest rates charged at origination. Above-market interest rates mitigate the higher risks faced by lenders, yet increase the costs and risks faced by vulnerable families. A second major market response occurs after purchase. Loss-mitigation efforts, which are attempts by lenders to achieve less costly alternatives to foreclosure, have achieved distinct successes but exhibit equally distinct shortcomings. Private financial firms have difficulty contacting delinquent borrowers and achieving financial solutions that last.

The second problem explored by this paper is a lack of adequate models for postpurchase education and counseling. These services have the potential to assist homeowners, but current provision occurs inconsistently as add-ons to the mortgage process. Postpurchase education and counseling are not integrated into the mortgage market for diverse reasons, including lack of research into its effectiveness, lack of capacity, cultural differences between private sector and nonprofit organizations and lack of proven models. Provision of postpurchase services currently poses a “chicken and egg” quandary. Research and pilots of sufficient scale are needed to attract resources and partners. However, resources and partners are needed to bring models to scale and to research their effectiveness. Thus, an opportunity exists for forward-thinking organizations and funders to fill this vacuum and to reinvent education and counseling as a strategy to sustain struggling homeowners.

Prevention vs. Intervention

A distinction should be made between programs for delinquent borrowers as opposed to programs offered to any homeowner regardless of mortgage repayment status. While conceptualizing the two program areas as a continuum makes sense for supporting homeowners, provision strategies, links to the market and client entry points are very different. *Delinquency counseling* specifically targets homeowners who are delinquent in repayment of their mortgage and who may or may not have been served a notice of foreclosure. Delinquency counseling usually occurs in one-on-one settings. As defined here, delinquency counseling refers to services provided by nonprofits that seek to assist delinquent borrowers as opposed to efforts from the loan servicer to structure a repayment plan. *Home-ownership sustainability training* offers skill classes and information to homeowners regardless of their repayment status. Outreach may be targeted to a specific profile of borrower or geographic location. Community organizations typically offer sustainability training in a group class format.[2]

[2] McCarthy and Quercia (2000) distinguish *education*, which imparts information and builds skills, from *counseling*, which addresses specific issues and typically occurs in a one-on-one context. Brown (2002) divides education into two types based on class setting: *training* is provided to a group, while *counseling* is provided to individuals.

Approach of This Paper

This paper asks the following questions: First, what potential do education and counseling have as strategies to address issues facing struggling homeowners? Second, how do models of postpurchase service delivery need to change in order to be more effective? Third, what stakeholders and research can help to drive expanded provision of postpurchase education and counseling? This analysis is based on a review of the academic literature, investigation of model programs, and interviews with practitioners and policy experts.

This paper examines information needs and strategies that can drive the provision of homeowner education and counseling. The analysis first assesses the current state of postpurchase education and counseling, including current understanding about the effectiveness and implementation of programs. Second, this paper draws implications from prepurchase counseling and private-sector loss mitigation. The effectiveness and implementation of prepurchase counseling are examined both as a comparison and for potential links between pre- and postpurchase services. Loss mitigation is explored both for its strengths and for areas of limitation that could be addressed by education and counseling. Third, current stakeholders in home-ownership outcomes are identified. Financial services, other private firms, and local governments have a stake in the success of homeowners. An explicit connection between education and counseling and the interests of those private and public actors can help to drive the provision of services.

A corollary issue raised by this paper is how to harness the value that counseling holds for the private sector without compromising the needs of homeowners. For instance, homeowners who understand the maintenance and repair needs of their investment require tools and materials. However, it is imperative that postpurchase programs do not steer homeowners toward unneeded products. Homeowners who are educated about their financial risks and opportunities will require loan and insurance products. At the same time, the education provided to those homeowners must support the freedom not to buy disadvantageous financial products. Distressed homeowners need financial solutions, such as loan modifications or emergency gap loans. Delinquent borrowers also need support after curing delinquencies. However, delinquent borrowers enduring stress should not be subject to undue solicitation. Homeowner education and counseling can improve the market by facilitating effective consumer use and demand for a very wide range of products. However, education and counseling should also serve families in contexts beyond the marketplace.

Theoretical Benefits of Postpurchase Education and Counseling

Education and counseling services have broad value for homeowners. They also have narrower, but largely unmeasured, value to multiple stakeholders. In particular, education and counseling play a preventive role that could prove cost-effective in responding to mortgage delinquency and default. Education and counseling are preventive in two senses. Postpurchase education prepares families to be successful homeowners, ideally leading to fewer repayment problems. At the same time, education prepares homeowners to diagnose and act on repayment problems should they occur. These functions of education and counseling have the potential to address the formidable difficulty that loan servicers face when attempting to contact delinquent borrowers. In addition, the provision of education and counseling can have important spillover effects for homeowners and other stakeholders, including private firms and local governments.

At present, evidence of the potential benefits of postpurchase education and counseling is almost entirely anecdotal; very little empirical evidence corroborates their effectiveness. However, based on the views expressed by housing counselors, community-development professionals and policymakers, postpurchase education and counseling theoretically can support homeowners.[3] Three roles of education and counseling that improve mortgage and housing markets are detailed below:

1. Market agents: Building a relationship of trust.

Home-ownership counselors establish trust with borrowers through personal interaction, delivery of helpful information and nonprofit status. This trust can result in increased homeowner disclosure of information and increased acceptance of advice from counselors. Mission-driven nonprofits that also have a sophisticated understanding of the financial industry can act as conduit, mediator, advocate and cheerleader as needed to promote the success of the homeowner. Nonprofits act as market agents in that they supply trust that is increasingly absent from transactions in the mortgage market. Increasing complexity in the financial services industry, frequent resale of servicing rights, unscrupulous lending practices, new populations of homebuyers unfamiliar with the mortgage process, and hard-to-reach delinquent borrowers all hinder trusting interactions between homeowners and firms in the mortgage industry.

2. Third-party perspective: Addressing a broad scope of issues.

Community-based counselors commonly address broad underlying issues with homeowners, either directly or through referral to other agencies. Whereas financial services, insurance and retail industries address the narrower issues of a delinquent loan or potential customer, education and counseling can address multiple family needs that may be more than financial. While not immune to market forces, third-party home-ownership counselors have less incentive to favor short-term solutions for homeowners over long-term ones. Housing counselors can provide information, skills and referrals relating to housing expenses, spending patterns, employment, legal issues, preserving equity and sources of assistance. Addressing these needs can assist families either to sustain their mortgage and housing commitments or to exit their home-ownership situation in a timely manner.

3. Information asymmetries: Informing decisions involved in home ownership.

Information is a misleadingly simple term for the process by which education and counseling can help homeowners to make informed decisions. Postpurchase services can assist homeowners to explore their comfort levels with the risks, rewards, contractual responsibilities and extent of physical maintenance involved in home ownership. In turn, homeowners can make more informed choices about their spending, saving and home-maintenance decisions. These choices may assist families to weather difficult economic events. In some cases, the comprehension gained may allow families to decide whether home ownership remains their best option. In contrast, trends in the mortgage industry toward rapid origination of loans, aggressive advertising and the proliferation of complex loan products are not conducive to thorough consumer comprehension of options before and after home purchase. This lack of consumer information translates into informational rents exacted from homeowners by private interests.

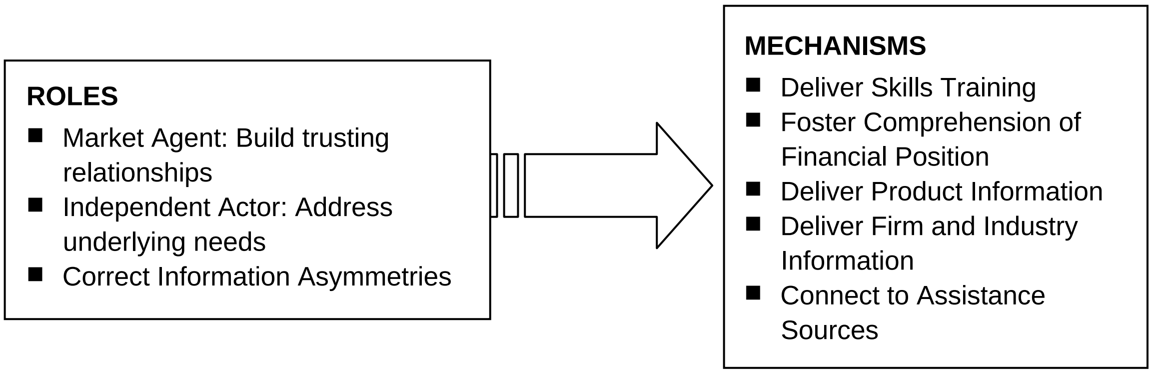
The three underlying roles listed above create a foundation for several mechanisms through which postpurchase education and counseling can assist homeowners to transact more successfully in the marketplace. These mechanisms include:

- Providing skills training such as budgeting and repair;
- Helping homeowners to understand the implications of their financial position;
- Improving consumer choice through product information such as home safety items, consumer credit or predatory loans;

[3] A list of individuals participating in interviews is included in an appendix to this report.

- Improving consumer choice through industry information, including the incentives and track records of lenders, loan servicers and other firms; and
- Informing homeowners about available assistance and resources provided through the public or private sectors

Figure 1. Roles and Mechanisms of Education and Counseling



Education and counseling cannot be expected to affect all underlying issues faced by homeowners. In some cases, the most appropriate role for postpurchase services is to help a homeowner to choose the best exit strategy. When counseling occurs late in a homeowner's financial difficulties or when issues are sudden and beyond the homeowner's control, counseling has a limited role. For example, delinquency counseling cannot address a divorce or a regional economic downturn that results in the loss of employment. However, counseling can assist the homeowner to access resources, explore options and alter budgeting and spending practices. A good example is Pennsylvania's Homeowner Emergency Mortgage Assistance Program, a revolving loan fund administered by state-certified counselors to assist homeowners in delinquency through "no fault of their own." Counseling connects those homeowners to a publicly provided product that benefits the homeowner, state and local governments and the mortgagee.[4] Just as important, counseling can encourage borrowers facing repayment problems to contact their loan servicers so that private-sector loss-mitigation efforts can proceed.

Finally, postpurchase education should not be considered a substitute for quality prepurchase counseling that prepares potential homeowners. It is likely that some well-informed families would not choose home ownership, perhaps because of unstable income, questionable housing markets or the need to move frequently. Several individuals interviewed for this report harshly criticized efforts from all three sectors to extend home ownership to underserved families without adequate preparation or attention to the risks involved.

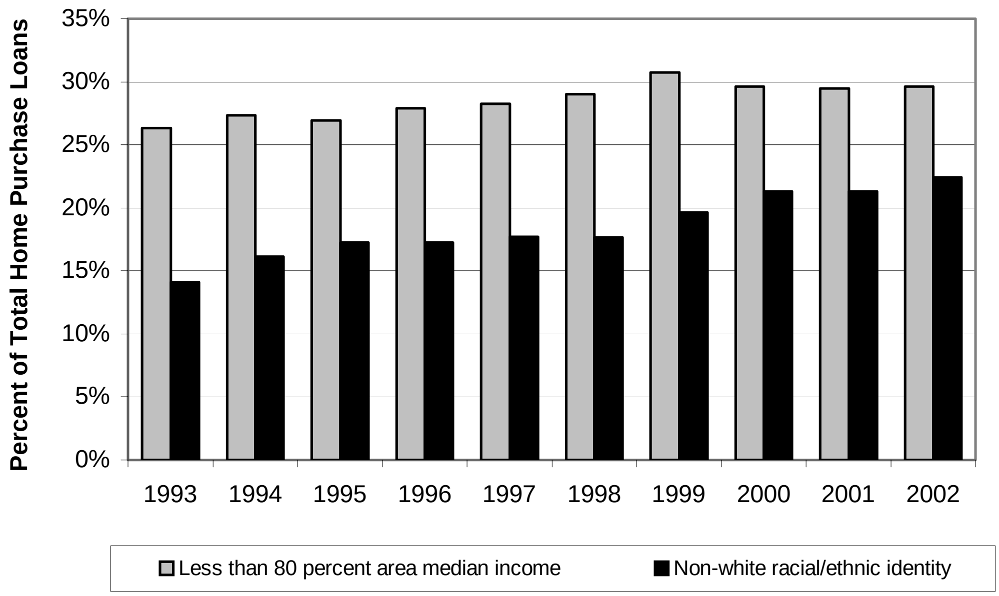
[4] Information on the Homeowner Emergency Mortgage Assistance Program is available at www.phfa.org/programs/hemap.

II. THE HOME-OWNERSHIP SUSTAINABILITY PROBLEM

Homeowner Difficulties

A decade of rising home-ownership rates has offered new opportunities to traditionally underserved families. Minorities have constituted 40 percent of the net growth of owners in the last decade, though the home-ownership rate for minorities still lags the rate for whites.[5] Low-income home ownership has also increased. Housing advocates leveraging the Community Reinvestment Act (CRA) and innovations in financial services have addressed many hurdles to low-income home ownership, such as access to credit and high down payments. Moreover, the social and economic benefits of home ownership make its extension a commendable goal. Home equity is the major vehicle for most families to build wealth. Home ownership is also associated with social benefits, such as higher levels of satisfaction and civic participation, as well as fewer problems at the neighborhood level.[6]

Figure 2. Growth in Underserved Borrower Home Purchase Loans



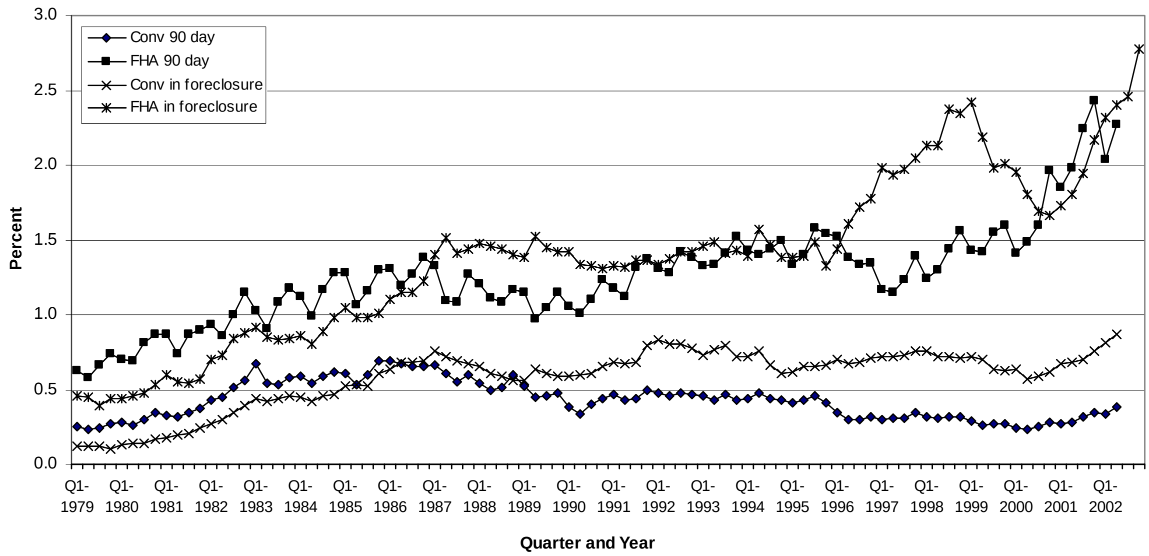
Source: HMDA data, 1993–2002.

Despite the benefits that accrue on average, some families struggle to sustain their home ownership. Affordability is one area of growing concern. For an increasing number of homeowners in all income brackets, housing costs eat up more than half of their gross income.[7] Cost is not the only issue; poor housing quality plagues some homeowners. Although housing quality continues to improve nation-wide, roughly 3 million households still occupy units with "moderate or severe" physical problems.[8] In rural areas, the problem of housing quality is worse, with greater percentages of homeowners living in deficient units.[9] Finally, when home ownership ends in foreclosure, both the family and the

[5] This figure covers the period from 1993 to 2002. Joint Center for Housing Studies (2003).
[6] Rohe, Van Zandt and McCarthy (2001).
[7] In 2002, over 10 percent of homeowners spent more than half of their gross income on housing, up from under 9 percent five years before. Joint Center for Housing Studies (2003).
[8] Census Bureau. Available at www.census.gov/prod/2002pubs/h150-01.pdf.
[9] Housing Assistance Council, Fact Sheet: *Rural Housing Quality.* Available at www.ruralhome.org.

community suffer. Foreclosure is not a new problem. However, national foreclosure trends for both conventional and FHA-insured loans have risen steadily for 20 years.

Figure 3. National Delinquency and Foreclosure Rates, 1979 to 2002



Source: Mortgage Bankers' Association.

Mortgage Delinquency

Mortgage delinquency is one measure of the financial struggles of homeowners. The proxy is not perfect. For instance, some families keep up on their mortgage payments but struggle to pay for other essentials. Mortgage delinquency does not measure quality of life, psychological stress from high cost burdens, loss of leisure time or inadequate housing units. Alternately, mortgage delinquency can represent a voluntary decision. Some borrowers default for financial advantage, for example when declining housing markets result in negative equity. Even when a family is clearly insolvent and cannot keep up with mortgage payments, the motivations and choices behind delinquency are more complex than inadequate income. Homeowners can have a mixture of financial and personal reasons to prioritize other expenses over mortgage payments even when it would be possible to stay current. Despite the imperfect correlation between mortgage delinquency and financially struggling home-owners, research on delinquency rates paints a reasonable picture of who is struggling and why.

Many homeowners become delinquent in their loan repayment for involuntary reasons. At the individual level, the predominant events that lead to delinquency include change in employment status, marital problems, illness or death in the family and other unexpected expenses. These events are interpreted by economists as involuntary "trigger" events that diminish the homeowner's ability to stay current on mortgage repayments.[10] In some cases, the trigger event can even consist of the "payment shock" that new homebuyers experience due to greater monthly housing costs.[11] Trigger events for an individual borrower may be part of a larger socio-economic pattern. For instance, rises in regional mortgage delinquency rates paralleled regional recessions through the 1980s and early

[10] See Gardner and Mills (1989); The Housing Council (2000).
[11] The Neighborhood Assistance Corporation of America found that payment shock was the largest factor that resulted in borrower's having difficulty staying current on mortgage payments. Interview with Bruce Marks, August 12, 2003.

1990s.[12] Recessions are accompanied by unemployment and slowed growth or declines in population. These factors create soft housing and labor markets that form a socio-economic backdrop to the individual-level causes of mortgage delinquency.

Borrowers may also become delinquent as a result of financial choices. Spending patterns can lead to repayment difficulty. For instance, some researchers attribute the rise in delinquency during winter holidays to homeowner spending choices that prioritize gift-buying over mortgage payments.[13] Often, new homeowners spend significant amounts on new furnishings, autos and other consumer goods. Community practitioners also report that many borrowers fail to prioritize mortgage debt over unsecured debt. Finally, homeowners may fail to budget for unplanned or routine increases in expenses. The need to maintain financial reserves or to comparison-shop for maintenance services can be foreign to first-time homebuyers.

The division between involuntary events and borrower choice is not a bright line. Borrower "choices" are based on the information available. If balanced consumer information is scarce relative to retail advertising or pressure tactics used by creditors, then consumer choices leading to delinquency are not fully voluntary. Conversely, "involuntary" events that lead to default sometimes stem from consumer choices such as spending and saving patterns.

Higher Risks for Underserved Borrowers

Underserved borrowers are particularly susceptible to underlying factors that result in difficulty sustaining a home or mortgage. The power of a trigger event to render a borrower insolvent depends on the magnitude of the event relative to the borrower's income, assets and loan terms. It is not surprising that borrowers with low or unstable income, few asset reserves and unfavorable loan terms experience greater problems. For instance, very low household income is associated with increased default risk.[14] Having fewer cash reserves on hand translates into increased likelihood of delinquency and default.[15] Since more than two thirds of the lowest income homeowners in 2001 had $1,000 or less in savings, many of these families would have difficulty weathering temporary economic setbacks.[16]

The rise in so-called predatory lending is another recent factor in the financial difficulties of traditionally underserved homeowners. Practices such as frequent loan flipping and excessive fees not justified by borrower risk profiles have cost American homeowners billions of dollars.[17] Even when lending practices are not clearly predatory, the burden of subprime interest rates and fees results in greater financial difficulty among vulnerable borrowers. In a study of four major metropolitan areas, subprime refinance loans foreclosed more quickly and constituted a disproportionately large share of foreclosures overall as compared with market-rate loans. Since subprime lending is disproportionately

[12] Capone (1996).
[13] Interviews with Steve Hornburg, June 25, 2003, and Vincent Terry, June 11, 2003.
[14] Van Order and Zorn (2000). This study of standard prime loans purchased by Freddie Mac showed that moderate household income was associated with the lowest level of default risk. As household income decreased below moderate income, the default risk increased.
[15] Steinbach (1995) as reported in Capone (2001). Steinbach reports that early delinquencies in affordable products in private mortgage insurer portfolios were 40 percent higher if borrowers did not have cash reserves of at least two months of mortgage payments.
[16] Joint Center for Housing Studies (2003). Of homeowners in the bottom quintile of income, 69 percent had savings of $1,000 or less. Source: Joint Center for Housing Studies estimates of 2001 Survey of Consumer Finances.
[17] Stein (2001). The Coalition for Responsible Lending estimated the loss at $9.1 billion annually.

concentrated in low-income and African-American neighborhoods, these underserved borrowers are rendered more vulnerable.[18]

Mortgage delinquencies offer valuable information, but researchers and practitioners must not be seduced into exploring home-ownership sustainability solely through the lens of delinquency, default and foreclosure. Home-ownership sustainability is a broader concept, encompassing hard-to-measure facets such as quality of life, community building and housing quality. For this reason, technical solutions to delinquency and default, such as adjusted loan terms or repayment plans, may be insufficient to address the broader needs of homeowners.

[18] Bunce, Gruenstein, Herbert and Scheessele (2000). This study examined subprime refinance loans.

III. CURRENT STATE OF POSTPURCHASE PROGRAMS

Sustainability Training

Sustainability training is a proactive effort to prepare current homeowners with the information and skills needed to meet the responsibilities of home ownership. Sustainability training is preventive and overlaps somewhat with topics overviewed during homebuyer training, including budgeting, insurance, home repairs and predatory lending.

Currently, sustainability training consists of skills training and information delivery in three substantive areas: physical maintenance of property, home safety and financial management. Physical-maintenance training involves hands-on practice at home repair and may also include training on dealing with independent contractors. Home-safety classes teach homeowners to prevent or detect damage. For instance, Neighborhood Reinvestment's National Insurance Task Force sponsors a Loss Prevention Program that focuses on a "single peril" at each of five NeighborWorks® organizations.[19] Financial-management education for homeowners includes budgeting for repairs, prioritizing debts, understanding tax obligations and learning the opportunities and pitfalls of various loan products. More fundamentally, budgeting classes teach basic financial literacy, including the uses of debt, savings and banking institutions.

Providers

Delivery of sustainability training is largely the province of nonprofit, community-based organizations. For instance, Neighborhood Reinvestment's Full-Cycle Lending® program incorporates a continuum of services modeled on state-of-the-art programs run by individual NeighborWorks® organizations. "One-stop" centers for home ownership offer training in budgeting and saving, but these are primarily geared toward potential homebuyers.[20] Sweat-equity programs, such as Habitat for Humanity, provide models of physical-maintenance training through homeowner participation in construction.

Elements of sustainability training can be found outside of housing-focused community organizations. Technology schools and college extension programs offer both home-maintenance and financial-management classes. Consumer Credit Counseling Service agencies are another source for financial-management training. Financial institutions often sponsor financial literacy classes, but these are mainly designed to prepare individuals to open accounts or become homeowners.[21] Finally, some businesses offer training. For example, Home Depot offers free in-store "how-to" clinics on home-repair topics.

The provision of instruction in these various settings varies from single sessions to semester-long classes. Costs to participants vary. Many programs are offered at little or no charge, while some centers charge $100 to $150 for a multisession class.

Effectiveness

The effectiveness of physical-maintenance and home-safety training has been measured only minimally with respect to several goals. In general, outputs of programs have been much easier to track than home-ownership outcomes. For instance, most programs track numbers of participants in

[19] Information is available at www.nitf.nw.org.
[20] The NeighborWorks® HomeOwnership Center® model is an example of home-ownership one-stop. The Department of Labor also sponsors a national network of one-stop employment and training centers that teach financial management. Information is available at www.doleta.gov/usworkforce/onestop.
[21] A survey by the Consumer Bankers Association (2001) documents the extent of bank-sponsored financial literacy training, though almost none of the training is targeted at existing homeowners.

classes, but few track the ability of those participants to perform home repairs or to deal with contractors after completing training. Self-esteem and psychological investment in the home are similarly unmeasured. Outcomes are also difficult to track in home safety programs. The Loss Prevention Partnerships pilot program is measuring the effect of classes and advertising campaigns on neighborhood-wide loss prevention behaviors. Baseline information has been collected, but information is not yet available for the impact of programs homeowner behavior. However, the program has documented upgrades in home safety that have been initiated by the participating NeighborWorks® organization.[22]

Goals of sustainability training in financial management include increased homeowner financial self-sufficiency and management of housing cost. That terrain is complicated to study. The NeighborWorks® Financial Fitness program has tracked the demographic profiles of participants; the program is currently developing assessment tools. However, that program largely targets potential homebuyers. A survey by the Consumer Bankers Association indicates that banks evaluate financial literacy effectiveness through pre- and postclass testing or through feedback from a partnering organization. Like other financial education efforts, these classes are geared mainly toward potential homebuyers or the "unbanked."[23] Very little empirical evidence exists about avoidance of delinquency through postpurchase financial literacy training for homeowners. Nevertheless, budgeting skills and avoidance of delinquency have a seemingly logical relationship that should be studied.

Postpurchase Model:
National Insurance Task Force

The National Insurance Task Force is a collaboration of property and casualty insurance firms, insurance trade associations, regulatory agencies, NeighborWorks® organizations and local governments. It seeks to expand partnerships between the insurance industry and community-based organizations in order to benefit communities.

Demonstration Project
- Five current locations: Chicago, Staten Island, Richmond, St. Louis and Denver.
- Advertising and education campaign targets "single peril" at each site, including fire, water, theft and wind damage.

Partners
- 15 insurance firms.
- 9 insurance trade associations.
- 21 community organizations.

Results
- 2,280 individuals educated in home-safety seminars.
- 839 home-safety inspections.
- 314 home-safety loans and grants made worth $1.66 million.

Source: 2002 Report of the Loss Prevention Demonstration Project. Information available at www.nw.org under National Insurance Task Force.

Current Implementation

Attendance: Levels of attendance are inconsistent for sustainability training. Providers market classes through newsletters, local media and fliers to businesses and lenders. In some cases, well-designed programs, minimal fees and densely populated service areas keep courses well attended. For example, Neighborhood Housing Services (NHS) of New York City and Long Island Community Development Corporation (CDC) operate two of the most successful home-maintenance training programs. In contrast, other providers report chronically low enrollment.[24] Even gift certificates from retailers and free merchandise do not always turn out crowds.

[22] NITF (2002).
[23] Consumer Bankers Association (2001).
[24] Ken Gross indicated that Chattanooga Neighborhood Enterprises, arguably one of the largest, most successful community lenders in existence, declined to offer home-maintenance training because of difficulty sustaining attendance. Interview, August 15, 2003.

Low attendance results from several factors. First, content and venue is important. Some programs teach home maintenance in incompatible venues, such as the public library, while others teach in more successful home-repair "laboratories" or on-site at rehabilitation projects. Outreach is a second factor. Some programs market mainly to existing loan clients. In contrast, Neighborhood Housing Services of Toledo operated a highly visible program in which only 20 percent of participants were current loan clients. The partnership between NHS of Toledo and Home Depot provided significant publicity.[25] In a new partnership with Neighborhood Reinvestment, Sears will fund sustainability training, including incentives and marketing. Finally, geography affects attendance. Despite significant need for home repair in rural areas, the dispersed population poses challenges for class attendance.

Two additional mechanisms that some programs use to spur homeowner participation are requirements tied to subsidies and informal education delivery. For instance, the Massachusetts Housing Partnership requires homeowners who receive a soft second mortgage to participate within one year of closing in HomeSafe, a class that covers repairs, insurance and foreclosure prevention.[26] Some public housing authorities require home-maintenance training for Section 8 recipients who are using their vouchers toward home ownership. Examples of informal education delivery include support for neighborhood associations and informal talks. Chicago NHS holds meetings on issues relevant to homeowners as a regular prelude to community policing meetings.[27] The Dudley Street Neighborhood Initiative in Boston continues to foster block clubs as a way to maintain informal homeowner networks.

Costs and Funding: Physical-maintenance training is usually offered in a group setting. The fees charged to participants vary, but they rarely cover the costs incurred by the organization. For instance, NHS of New York offers a home-maintenance training program that costs $30,000 annually. Fees to participants cover less than a third of total cost. A variety of banks plus a few insurance and retail firms cover the remainder.[28]

Most funding for the provision of sustainability training occurs on a grant basis. Foundations and government funding can jumpstart projects, as the Ford Foundation did for the National Insurance Task Force. However, broader support is needed to bring programs to scale. Depository institutions can receive credit under the CRA investment test for providing grants to community organizations for homeowner education. Partnering retailers provide operating funds and incentives for participants. The Sears-Neighborhood Reinvestment Corporation partnership is an example of significant private commitment. Sears has committed $2 million in the first year. These funds will provide financial assistance for homebuyers, operating support for organizations and training programs.

Delinquency Counseling

Delinquency counseling attempts to bring borrowers current on their mortgages or to terminate tenure when necessary through less costly or traumatic means than foreclosure. As used in this paper, delinquency counseling refers to the services provided by a nonprofit housing-counseling agency as

[25] At the time of this writing, Home Depot has discontinued its relationship with NHS Toledo. Nancy Dey, executive director, attributes the termination to a turnover of key supportive management personnel at Home Depot. Focus group, August 19, 2003.
[26] Available at www.mhp.net/homeownership/education.php. The Massachusetts Affordable Housing Alliance (MAHA) developed and currently implements HomeSafe. Additional information can be found at www.mahahome.org.
[27] Interview with John Groene, June 12, 2003.
[28] Based on the Neighborhood Reinvestment publication, "Winning Strategies" (2002), available at www.nw.org.

opposed to loss-mitigation efforts by private loan servicers. Delinquency counseling has several components, including (1) identifying the cause and extent of delinquency, (2) assessing the motivation and resources of the borrower to reinstate, (3) teaching budgeting skills and reviewing the borrower's financial position, (4) negotiating with creditors to arrange repayment plans or modifications, providing referrals for underlying needs, and (5) exploring subsidy programs and foreclosure alternatives.[29] Delinquency counselors usually have no delegated ability from the loan servicer to authorize repayment plans or modifications. Rather, counselors act as intermediaries in the negotiation between borrower and servicer. Delinquency counseling is typically provided in a one-on-one setting and may occur over multiple sessions.

History

Foreclosure prevention constituted a strong initial thrust of housing counseling funded by HUD. The Housing and Urban Development Act of 1968 established HUD's authority to provide or fund counseling for borrowers insured by the Federal Housing Administration as well as for non-FHA borrowers.[30] HUD developed foreclosure-intervention programs partly in response to high rates of default on its Section 235 program.[31] During the 1970s, delinquency counseling usually operated in contradistinction to mortgage industry norms that attempted to expedite rather than prevent foreclosure.

Emphasis on delinquency counseling waned as prepurchase counseling became a major thrust for the lending industry. With the inception of affordable housing goals for Fannie Mae and Freddie Mac in 1992, these government-sponsored enterprises (GSEs) increasingly supported prepurchase counseling as a means of reaching eligible borrowers.[32] Other lenders have shown similar interest in prepurchase counseling especially as a means of meeting CRA requirements. Today, most housing counseling agencies nominally provide delinquency counseling. For instance, the majority of HUD-funded housing counselors list delinquency counseling as an offered program area. However, many of these agencies provide only occasional service and do not have staff specifically available for delinquency counseling.[33]

Effectiveness

Empirical research about the effectiveness of delinquency counseling is outdated and inconclusive. A series of studies in the 1970s examined the effectiveness of counseling in reducing the likelihood of delinquency for a number of HUD programs, most notably the section 235 program. However, these studies predate innovations in loss mitigation. At the time of study, delinquency counseling was virtually the only effort targeted at preventing foreclosure among seriously delinquent borrowers. Innovations in loss mitigation along with flaws in the studies render the results irrelevant for contemporary delinquency counseling.[34]

The effect of delinquency counseling in the context of private-sector loss mitigation is not clear. When delinquency counselors advocate for a borrower, they typically negotiate with loss mitigation departments of loan servicers. However, both the counselor and loan servicer have an interest in

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[29] The HUD Housing Counseling Handbook (7610.1 REV-4) lists these functions. Many of them are echoed in the promotional materials of community-based counseling agencies.
[30] HUD Housing Counseling Handbook (7610.1 REV-4), chapter 1-1.
[31] In the Section 235 assignment program, HUD makes payments on behalf of the mortgagor directly to the mortgagee for eligible borrowers.
[32] See McCarthy and Quercia (2000) for a discussion of the screening function of prepurchase counseling for affordable mortgage markets.
[33] HUD-funded counseling agencies document the types of counseling that they provide on HUD form 9902. Rohe, Quercia and Van Zandt (2002) suggest that many agencies lack regular delinquency counseling staff and provide the service on an occasional basis.
[34] Quercia and Wachter (1996)

preventing foreclosure. It is not clear what effect delinquency counseling has on the likelihood or quality of workouts as distinct from the effect of the loss-mitigation efforts by the servicer. Since loan servicers vary in their practices and quality, measurement of delinquency counseling must account for these differences.

Figure 4. Progression of Mortgage Delinquencies- 1990s Model[35]

30 Day Progressing to 60-90 Day Delinquency	60-90 Day Progressing to Foreclosure Start	Foreclosure Start Resulting in Completed Foreclosure
Starting with 100 30-day delinquent borrowers: ■ 11 will miss a second payment	■ 4 of the original 100 will miss a third payment (foreclosure can be started by lender)	■ 2 of the original 100 will go to foreclosure *Source: Fannie Mae*[36]
■ 50 percent cure without intervention ■ 25 percent in servicer-sponsored repayment plan ■ 25 percent progress to 60+ days	■ 40 percent go to foreclosure	■ Completion depends on LTV, market ■ Roughly half complete foreclosure *Source: Capone (1996).*

Another unknown is the population of delinquent borrowers who approach delinquency counselors. Some of these counseled borrowers would otherwise be unreachable by loan servicers. Understanding which delinquent borrowers approach counseling agencies is crucial for establishing the role of counseling. Unfortunately, this information remains unmeasured. For example, HUD form 9902 gathers data from agencies about the number of borrowers counseled and the number who remain in their homes. For fiscal year 2001 (the most recent data available), 31 percent of the 150,000 borrowers receiving delinquency counseling were able to maintain their housing. Since counseling agencies often handle the most difficult cases of serious delinquency, it is quite possible that many of the 50,000 borrowers who remained in their homes would have been subject to foreclosure without counseling assistance. On the other hand, many delinquent borrowers will cure on their own before being served notice of foreclosure. Finally, measurement of borrowers remaining in their homes does not account for counseling that resulted in favorable exit strategies for those borrowers who terminated tenure.

Current Implementation

Referral: Intake for counseling often occurs late in delinquency, when the homeowner's options are limited and counseling is costly. The financially distressed homeowner typically contacts the housing counseling agency, rather than vice versa, since privacy laws prohibit counselors from identifying delinquent borrowers. Thus, counseling agencies must rely on delinquent borrowers to take initiative, despite many borrowers' refusal to respond to their deteriorating financial situation. One salient exception to the privacy barrier occurs when the homeowner used the same counseling agency for prepurchase education and signed a release. A crucial distinction for nonprofit providers of counseling is whether the delinquent borrower is a prior client of prepurchase or lending services. Nonprofit lenders often have internal systems to deal with their own clients who become delinquent.

Delinquent borrowers who have no prior history with the nonprofit are referred through several sources. Commonly, loan servicers include the contact information for local counseling agencies in letters at various stages of delinquency. For example, FHA mandates that delinquent borrowers must

[35] Note that loss-mitigation techniques have advanced since the date of these formulations.
[36] "Fannie Mae Announces Unique Loss Mitigation Tool For Servicers," Sept 15, 1997. America On-Line News.

be sent the HUD pamphlet, "How to Avoid Foreclosure," no later than 45 days into the delinquency.[37] This pamphlet directs delinquent borrowers to a HUD phone number and Web site in order to locate a local HUD-approved housing counselor. As another example, Pennsylvania state law requires lenders starting foreclosure to send a notice that lists local housing counselors who administer loans through the Homeowner's Emergency Mortgage Assistance Program. Delinquent borrowers then have 30 days to contact the counseling agency.[38] Administrators of these programs suggest that borrowers who do not respond to loan servicers' letters and phone calls are similarly unlikely to approach housing counselors until foreclosure is imminent.

Some community-lending organizations do proactive outreach to delinquent or financially distressed borrowers. Neighborhoods, Inc. of Battle Creek, Michigan, developed a postpurchase initiative that includes in-person contact with vulnerable homeowners and targeted budgeting and maintenance classes. For the most part, community organizations are limited to either a scattershot approach or to targeting of their own customers when attempting to reach borrowers proactively. Lack of funds typically limits such outreach efforts.

Funding: Current funding of delinquency counseling is insufficient and poorly allocated relative to the demands on counseling organizations. Most nonprofit providers of delinquency counseling indicated that this type of counseling is much harder to fund than prepurchase counseling.[39] Several providers noted that they follow a tacit strategy of establishing delinquency counseling capability but keeping a low profile to avoid a deluge of requests for services that cannot be funded. HUD's fiscal year 2004 budget doubles funding for housing counseling, bringing the total to $38 million. Unfortunately, even this amount is spread too thin. In 2002, the average HUD grant to a housing counseling agency was $17,000 for all counseling activities combined.[40] No HUD funds specifically target delinquency counseling, though a pilot in Miami is exploring a model of attaching fee-for-service payments to referrals.[41]

Lending institutions and state or local governments also fund housing counseling. Grants to community-based organizations help depository institutions to meet the investment test of the Community Reinvestment Act. States and cities can allocate some portion of their Community Development Block Grants (CDBG) and HOME funding to home-ownership counseling. For instance, Philadelphia allocated over $4 million for housing counseling in fiscal year 2003, with a slight increase in fiscal year 2004 to fund anti–predatory lending and legal services.[42]

St. Ambrose Housing Aid Center of Baltimore, MD

St. Ambrose founded its Default Mortgage Counseling program in 1974. The program currently serves 1,000 families per year, and approximately 60 percent keep their homes at least temporarily. Until 1996, the Default Counseling program saw mostly delinquency cases involving divorce, unemployment and medical problems. In 1997, St. Ambrose encountered some of the first borrowers who were delinquent due to lack of budgeting or uncompetitive loan terms. By 2001, almost all delinquency cases seen by the agency fell into this category. Executive Director Vincent Quayle suggests that St. Ambrose could occupy as many delinquency counselors as it could fund.

Source: Interview with Vincent Quayle, Executive Director, July 10, 2003.

[37] Interview with Laurie Maggiano, August 7, 2003.
[38] Information on HEMAP is available at www.phfa.org/programs/hemap/ps.htm.
[39] Based on interviews conducted for this study. This sentiment was almost universal.
[40] Collins (2002).
[41] Colleen Weiser currently manages the Miami Pilot for HUD.
[42] www.phila.gov/ohcd/conplanfiles/29budgetdetail.pdf.

Instances of business models for the funding of delinquency counseling are exceedingly rare. Business models are hindered by a lack of empirical evidence of delinquency counseling effectiveness as well as the lack of counseling capacity and the upfront costs required to build that capacity. Furthermore, HUD funding for housing counseling prohibits conflicts of interest, such as acting in the capacity of collection agent, servicing the mortgage and acquiring the property from the trustee in bankruptcy. These regulations would need to be clarified before funding agreements between loan servicers and delinquency counselors could proceed.

IV. COMPARATIVE ANALYSIS

Prepurchase Education

Prepurchase education and counseling provides a relevant comparison for both sustainability training and delinquency counseling. This inquiry probes both the lessons that can be drawn from the provision of prepurchase counseling as well as the opportunities for links between pre- and postpurchase services. This inquiry probes (1) current information about effectiveness and (2) implementation, including referral and funding.

Effectiveness

While prepurchase counseling has broad benefits for the homeowner, its narrower effect on mortgage delinquency has received prominent attention. Empirical evidence links prepurchase counseling to lower risk of delinquency and default. A study of Freddie Mac loans showed that the likelihood of ever reaching 90-day delinquency was reduced by 19 percent for borrowers who received counseling, and was reduced by as much as 34 percent for borrowers who received one-on-one counseling.[43] A study at Ohio State University found that counseled borrowers had half the default risk as non-counseled borrowers.[44] The effectiveness of prepurchase counseling remains difficult to assess, but trends toward standardization have facilitated measurement.

At least two mechanisms underpin the effectiveness of prepurchase education. First, potential homebuyers learn the process and pitfalls of homebuying as well as skills for successful purchase and ownership. Second, some potential buyers delay or decline purchase. Because prepurchase counseling is costly to homebuyers in terms of time or money, participation signals to lenders that participants are willing to expend effort toward attaining home ownership. In turn, this suggests that they are worthy credit risks.[45]

Decreased risk of default translates into financial value to mortgagees and other stakeholders. The exact value of decreased risk of default depends on the costs of default and the amount that risk is decreased. It is not enough to compare foreclosure costs with counseling costs, since counseling does not always prevent foreclosure. Instead, the decreased probability of eventual foreclosure multiplied by the costs of foreclosure should be compared to the costs of counseling. Most delinquent borrowers will cure their delinquency without intervention, even at 90 days delinquent. Therefore, the costs of counseling should be compared with the expected savings from decreased probability of mortgage default.

Implications: Information about the effectiveness of prepurchase counseling is important to strategies for provision of postpurchase services in two ways. First, this information establishes the effectiveness of education and counseling as a tool to address mortgage delinquency. Although the specific mechanisms that reduce delinquency may differ between pre- and postpurchase services, the research raises the possibility that postpurchase education and counseling can also impact delinquency. Second, the available research suggests highly variable effectiveness based on the delivery format. It is quite possible that economically optimal levels and models of counseling have not been reached. An extended counseling program that includes postpurchase components may have a large effect. Furthermore, the effect of postpurchase training may interact with the effect of prepurchase training to result in greater effect than either component would have alone.

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[43] Hirad and Zorn (2001).
[44] In Brown (2002).
[45] See Capone (2001) for a discussion of two studies that examine participant decisions to purchase after prepurchase counseling.

Implementation

Referral: Lenders and subsidy providers regularly refer potential buyers to prepurchase counseling. For example, Rochester (NY) Neighborhood Housing Services estimates that 85 percent of its prepurchase clients are referred by the city of Rochester, which requires prepurchase counseling before awarding closing cost and other assistance. Most of the remaining customers of Rochester NHS are referred by lending institutions; very few seek home-ownership counseling on their own.[46] The Federal Home Loan Bank's Affordable Housing Program (AHP) requires that borrowers receiving assistance through that program participate in prepurchase counseling. On the other hand, many mortgagors do not receive prepurchase counseling. For example, only 10 to 15 percent of clients of the Vermont Housing Finance Authority receive prepurchase counseling, partly due to lack of counseling capacity in rural areas.[47]

Some prospective homebuyers respond to direct marketing. For example, nonprofit organizations solicit potential homebuyers through brochures, homebuyer "fairs" and neighborhood outreach activities. Outreach techniques vary; Ithaca (NY) Neighborhood Housing Services conducted a two-year marketing campaign for home ownership, funded by a $50,000 grant from Neighborhood Reinvestment. On the other hand, McAllen Affordable Homes, in South Texas, reaches a mostly Latino population through word of mouth.[48]

Efforts to Support Homeowners: Vermont Housing Finance Authority

Vermont HFA purchases 750 to 1,000 loans annually; most of these are first mortgages. Though small in volume, VHFA has taken numerous steps to support homeowners.

VHFA's Interests
- VHFA estimates that it loses $7,000 per foreclosure after reimbursement from MGIC (which covers 30 to 35 percent of indebtedness plus expenses).
- Foreclosure costs have decreased from roughly $20,000 more than a decade ago.
- Foreclosures plus 60+ day delinquencies are 2.5 to 3 percent; foreclosures are under 1 percent.

VHFA Loan Servicing
- VHFA owns and subcontracts servicing rights on half of its loans.
- VHFA becomes actively involved at 60-day delinquency.
- Loan workouts are achieved on one quarter of defaulted loans before starting foreclosure.
- Another quarter of foreclosure starts result in a loan workout before completion.

Partnerships with Counseling Agencies
- VHFA offers $27,000 operating and marketing grants to community agencies offering home-ownership counseling, plus $300 per counseled homebuyer.
- VHFA's database links loans to the community agency and individual counselor that provided prepurchase counseling to the borrower.
- After 30 days delinquent, VHFA regularly refers borrowers to housing counseling agencies.
- Approximately 10 to 15 percent of VHFA borrowers attend prepurchase counseling.

Source: Interview with Director of Homeownership Pat Crady, August 20, 2003.

[46] Interview with Rosa Hannah, July 7, 2003.
[47] Interview with Pat Crady, August 20, 2003.
[48] Interview with Robert Cavillo, July 21, 2003.

Funding: Most prepurchase counseling is funded by grants. However, grants do not always cover the approximately $100 to $300 per participant that counseling costs.[49] This makes it difficult for counseling agencies to offer quality services or to cross-subsidize postpurchase elements that are usually harder to fund. HUD conflict-of-interest restrictions limit the development of fee-for-service and cost-recovery models. Attaching funding to the quality of home-ownership education models could spur innovation and increase accountability of prepurchase programs. The same point can be made for postpurchase programs.

Implications: The implementation of prepurchase programs suggests three main lessons for post-purchase services. First, unlike postpurchase programs, prepurchase counseling is an integral component of affordable lending models for many lenders. Second, funding for prepurchase counseling follows from the integration of counseling into lending models. Regardless, prepurchase counseling still suffers from insufficient funds. In part, this is because lenders are unwilling to fully fund programs when the benefits cannot be captured, meaning that participants may go to any lender they choose after homebuyer training. A third implication for postpurchase counseling is that a wide variety of prepurchase programs exist, both in terms of program and clientele. The diversity of such programs offers fertile ground for experimentation to determine the effectiveness of more comprehensive programs in a variety of markets.

Loss Mitigation

Loss mitigation is a major market response to mortgage delinquency and default. Since the magnitude of this response dwarfs efforts in the nonprofit sector, loss mitigation is an important backdrop for the operation of education and counseling programs. This analysis probes both the successes achieved and the current limitations of loss-mitigation efforts.

Background

Loss mitigation is the attempt by the financial services industry to reduce the costs that result from foreclosure on homes owned by delinquent borrowers. Loss mitigation is motivated by the economic incentive of the mortgage industry to prevent foreclosure. Techniques involve early detection of problem loans and targeting of alternatives to foreclosure based on the particulars of the borrower's situation. In general, loss-mitigation solutions fall into two categories: those that keep the borrower in the home, and those that terminate tenure. Keeping the borrower in the home tends to be less expensive for the mortgagee, so these options usually are explored first.[50]

Loss mitigation does not necessarily follow a linear progression. However, the following strategies are listed roughly in order of increasing cost to the lender. Loss-mitigation strategies that keep the borrower in the home include: (1) repayment plans that cover the full amount of back payments plus lost interest, (2) loan forbearance during a temporary period, and (3) modification of the loan terms. Loss-mitigation strategies that end the tenure of the homeowner include: (4) home sale with loan assumption by the new buyer, (5) preforeclosure (short) sales, and (6) deed-in-lieu of foreclosure.[51]

Loan servicers pursue loss mitigation on behalf of the investors, portfolio holders or insurers of the mortgage. The servicing agreement specifies the range of alternatives to foreclosure that the servicer can or must pursue. Servicers have different incentives than the owner of the mortgage. Typically, servicers receive a per-loan fee or percentage from the owner or investor, then attempt to minimize

[49] Collins (2002).
[50] Capone (1996).
[51] These terms are defined in the glossary at the end of this paper.

costs. These costs include servicing the loan and paying for foreclosure costs not absorbed by either the owner or insurer of the loan. Additionally, the bearer of risk may offer incentives to the servicer for achieving a variety of workouts. These incentives come in the form of direct payments and tiered rankings that confer valuable benefits on high-performing servicers. Fannie Mae, Freddie Mac and the FHA all have some form of incentives for servicers to pursue workouts.

Several factors have driven the evolution of alternatives to foreclosure.[52] Early efforts to reduce the loss from delinquent loans attempted to increase efficiency in the processing of foreclosures. However, even expedited foreclosures proved costly to mortgagees. Capone (1996) demonstrates a scenario in which the lender would lose tens of thousands of dollars on a foreclosure on a conventional loan (20 percent down payment). High loan-to-value ratios, declining housing markets and regulations in some states increase the loss. Losses on foreclosures may total 30 to 60 percent of the outstanding loan balance.[53] Regional recessions in the 1980s coupled with new lending products to address rising interest rates seriously increased default risks to lenders and mortgage insurers. In addition, a series of legal cases highlighted the difficulties of reinstatement for good-faith borrowers once foreclosure proceedings were started.[54] These factors, combined with increasing concentration of the industry, have spurred innovation. By the early 1990s, loss-mitigation policies were normal procedure in servicing agreements.

Implications: Two main implications can be drawn for postpurchase education and counseling. First, the lending industry is focused on loss mitigation as a response to mortgage delinquency. This means that lenders ascribe successes to loss-mitigation technology and the economies of scale that allow technological solutions rather than to intensive personal efforts. The mortgage industry and relevant public-policy advocates are unlikely to support delinquency counseling that does not coordinate with the efforts of private-sector loss-mitigation efforts. Second, regional recessions as well as natural disasters in the past have spurred innovations in loss mitigation. At the time of this writing, the lagging national economy may provide impetus for further experimentation in preventing delinquency and default.

Effectiveness

Targeting: Loss mitigation has been successful at generating accurate predictive models and at matching borrower circumstances with appropriate loan workouts, which are attempts to resolve the delinquency through repayment or exit. Early intervention for delinquent borrowers is critical for the eventual success of workouts that aim to keep the borrower in the home. However, most delinquencies, even at the 60- to 90-day late period, will cure on their own.[55] Thus, indiscriminate intervention for early delinquencies is costly and inefficient.

Mortgage insurers and the GSEs developed a series of technology products that have the ability to identify those loans that are most likely to progress to further delinquency and default. Both EarlyIndicator℠, developed by Freddie Mac and the Mortgage Guaranty Insurance Corporation (MGIC), as well as Risk Profiler℠, developed by Fannie Mae, have proven accurate in their ability to detect problem loans. For instance, loans identified as high risk by Risk Profiler℠ are 15 times as likely to reach 90-day default as loans identified as low-risk.[56] However, the ability to detect problem

[52] This treatment of the history of loss mitigation borrows heavily from Charles Capone's "Alternatives to Foreclosure" report to Congress (1996).
[53] Capone (1996), pp. 39–40.
[54] *Brown v. Lynn* 385 Fed.Supp.986 (1974).
[55] See figure 4, earlier in this paper.
[56] Based on the presentation given by Larry Cordell, Director of Information Engineering, Freddie Mac, at the 2001 Conference on Housing Opportunity, sponsored by the Research Institute for Housing America. The PowerPoint file for the

loans is not enough to prevent foreclosure. Accordingly, the GSEs have developed tools to match effective workout options with the circumstances of the delinquent borrower. Early Resolution[SM], an automated workout product developed by Freddie Mac, digests information about the loan characteristics and financial position of the borrower to return an appropriate workout strategy.

Workout Rate: Loss-mitigation efforts by the private sector have significantly increased the proportion of delinquent borrowers who are able to stay in their homes. Fannie Mae improved its overall workout rate to over 50 percent of 90-day delinquent loans in 2002, representing almost 22,000 workouts. In addition, over 90 percent of those workouts resulted in the borrowers staying in their home.[57] In 2001, Freddie Mac settled over 6,000 foreclosure alternatives.[58] FHA loans have also seen rising workouts; in 2002, workouts surpassed foreclosures. One important caveat to these successes is the extent to which these firms have changed other practices that would affect workout rates. For example, increasing the use of recourse by sending nonperforming loans back to lenders of origin or selling off nonperforming loans to specialty buyers would tend to exaggerate the successes of loss mitigation.

Intensive Subprime Loan Servicing Operations: Countrywide Home Loans, Inc.

Countrywide services over 3.8 million loans totaling over $430 billion. In 2001, Countrywide serviced 250,000 subprime loans, in addition to special servicing of nonperforming loans. The firm represents some of the most capable efforts in the loan servicing industry. In 2001, Standard & Poor's gave Countrywide its highest rating of "strong" in all servicer categories.

Subprime Servicing Procedures

- Welcome call to borrowers within five days of loan entry into servicing portfolio.
- Contact made to first-time defaults on second day after payment's due date.
- Telephone contact attempted every other day between 30 and 45 day delinquency; every day after 45 days.
- Analysis at 60-day delinquency returns best workout or exit strategy based on borrower financials, property valuation and costs of foreclosure, eviction and real estate marketing.
- Use of software including Freddie Mac's Workout Prospector and Fannie Mae's Mornet.
- Branch visits to geographic areas with concentrated delinquencies; mailers sent out.

Results and Statistics

- Average cost to service of $106.57; 561 loans serviced per servicing employee.
- 82 percent of delinquent borrowers that promise to pay cure their delinquencies.
- Overall delinquency of 11.53 percent (Jan. and Feb., 2001) comparable to industry peers.
- Loan workout turnaround in 24 hours.

Branch Visits

- Approximately 50 percent response to mailers sent in advance of branch visits.
- Approximately 80 percent of responders have in-person appointment.
- Approximately 95 percent of appointments result in loan workout.
- Approximately half of loan workouts succeed over time.

Source: Interview (8/11/03) with Sandy Samuels, General Counsel and Kim Lott, VP of Loss Mitigation; Standard & Poor's Evaluation (2001), available at subservicing.countrywide.com/ratings/Countrywide%202001.pdf.

presentation is available at www.housingamerica.org/downloads/web4.ppt. A published paper is forthcoming from Larry Cordell and Amy Crews Cutts.

[57] Interview with Danny Smith, July 3, 2003. The workout rate includes repayment plans.

Servicers of subprime loans have implemented some of the most intensive efforts to service delinquent loans. Many subprime loan servicers initiate telephone contact as soon as loans enter their servicing portfolio. Additionally, subprime servicers often follow an intensive schedule of contact for delinquent borrowers, including mailings, phone calls, site visits to areas of concentrated delinquencies, and personal appointments with delinquent borrowers. These efforts are narrowly targeted at the goal of curing delinquencies, rather than at addressing underlying causes of delinquency. Regardless, the statistical effectiveness of many servicers in achieving workouts is impressive.

Implications: Advocates for postpurchase education and counseling should take two main lessons from the empirical effectiveness of loss mitigation. First, loss mitigation statistically can achieve workouts that keep borrowers in their homes, and the mortgage industry has an incentive to pursue workouts aggressively. This implies that some coordination between loss mitigation and delinquency counseling is both possible and potentially beneficial for multiple stakeholders. Second, as loss mitigation culls the delinquencies that are easiest to cure, the pool of cases seen by counselors will change. The hardest cases, those never contacted by servicers, will be more frequent clients of delinquency counselors, resulting in greater resources needed per client. Community-based organizations need to understand how servicers triage borrowers, both to understand the potential role for counseling and to stay vigilant for issues of disparate treatment by servicers.

Differentiation Among Firms

Loan servicers vary in their portfolios and procedures. It would be tremendously valuable for community groups to differentiate between the quality and practices of various servicers. For instance, HUD divides servicers of FHA loans into four size categories. The largest service over 100,000 loans, while the smallest category service under 1,000. Servicer performance varies both nationally and by region. HUD publicizes an overall ranking of servicers based on their performance on keeping the default rate down and on minimizing costs to HUD. These rankings are available on the HUD Web site.[59] Standard & Poor's also publicizes some limited information on its Web site regarding its rankings of loan servicers, though this information is geared toward investors.[60] These information sources alone are inadequate to allow community groups to evaluate the quality of loan servicers as measured against homeowner needs.

Limitations

The statistical effectiveness of loss mitigation in some contexts belies other shortcomings. The most consistent problem that resonates across servicers, lenders and mortgage insurers is the inability to reach some delinquent borrowers. Practitioners and financial-industry executives alike hypothesize that fear of foreclosure or refusal to acknowledge financial problems keeps delinquent borrowers from making contact. It is also possible that variable retail loan outlets, frequent resale of servicing rights and changes in borrower telephone service lead to inconsistent contact information. Overview data is not available for the industry, but a very rough guess would be that half of delinquent borrowers do not respond to outreach by servicers.[61] Servicers have experimented with videos, creative mailings and third-party contact, yet the problem persists. This issue may point to the need for a local presence and a relationship of trust in order to reach borrowers. However, counselors may have no more success at contacting delinquent borrowers if they are involved only at the point of delinquency.

[58] Freddie Mac, 2001 Annual Report.
[59] www.hud.gov/offices/hsg/sfh/nsc/perform.cfm.
[60] Available at www.standardandpoors.com.
[61] Based on interviews with executives at Countrywide Mortgage Co., Fannie Mae and PMI. The author of this paper is solely responsible for this estimated figure. It should not be construed as representing the performance for a particular firm, loan type or borrower profile.

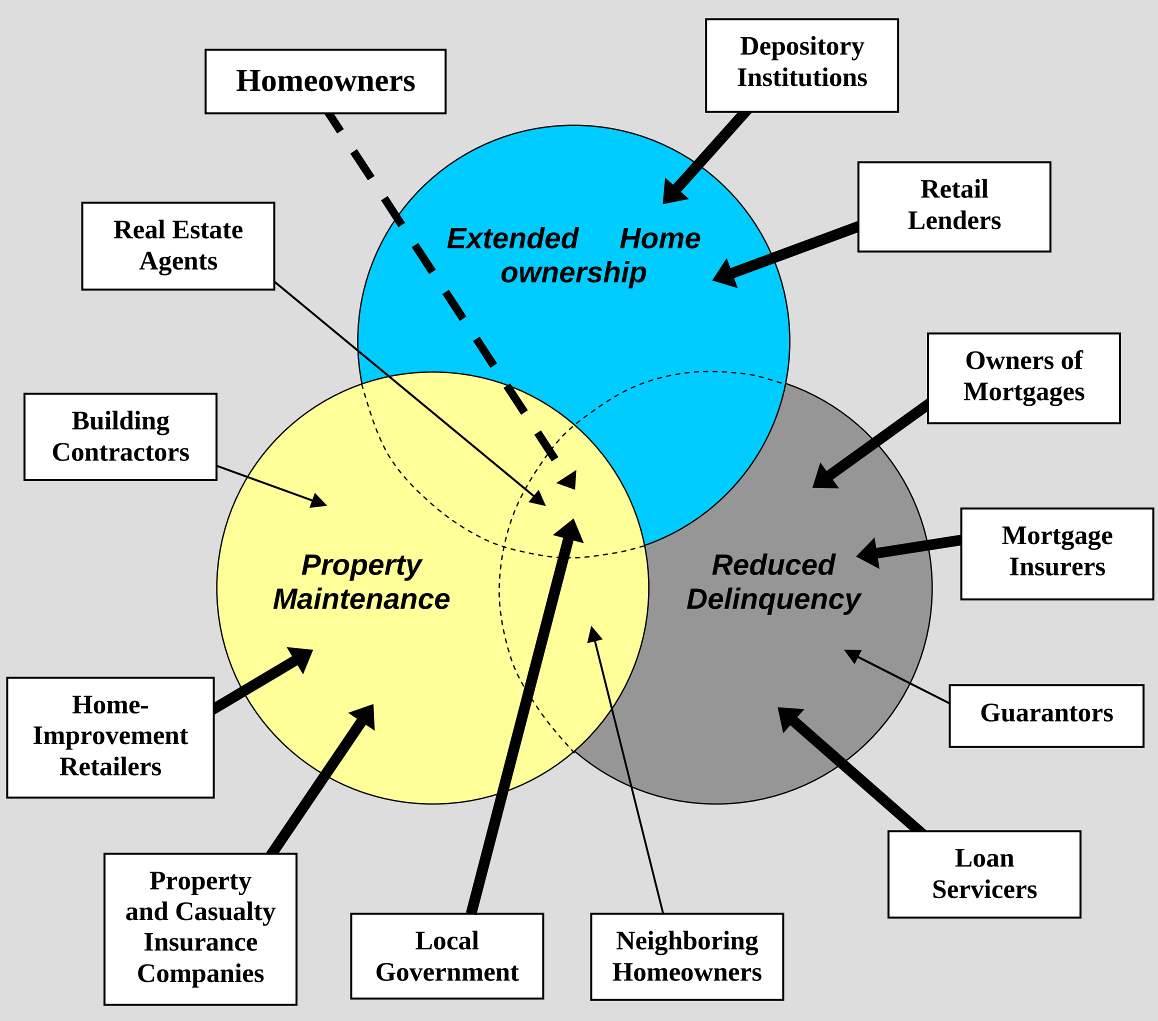
While workout rates have been high, the proportion of those workouts that result in full repayment is not as high. Failure rates are generally not public information, but several servicers reported that workout success rates can be 50 percent or less. This does not necessarily mean that servicers are choosing faulty workouts or not making enough effort. These cases may not be amenable to financial solutions if the financial circumstances of the family are untenable. In cases where origination of the loan was imprudent, servicers may have little ability to effect a workout that keeps the borrower in the home. However, a role may exist for broader solutions than those that specifically target mortgage delinquency.

V. STAKEHOLDER ANALYSIS

This section attempts to frame in broad terms the types of stakeholders that can drive the effective provision of postpurchase education and counseling. While homeowners collectively need a broad continuum of services, each stakeholder typically cares about a smaller slice of outcomes. This analysis aims to shed light on the differing interests of stakeholders in order to understand which actors can be involved in developing more comprehensive and effective homeowner education and counseling programs. This presentation stylistically divides stakeholders into distinct functions. In reality, large firms or organizations often house multiple stakeholder functions under one roof.

This analysis suggests that stakeholders are invested in outcomes regarding home ownership, rather than in the specific programs offered by community organizations. Conceptually, home-ownership outcomes can be divided into three categories: extension of home ownership, property maintenance and reduced delinquency. Extension of home ownership refers to new opportunities for home ownership extended to currently underserved populations. Property maintenance refers to the upkeep of homes, property and neighborhoods. Reduced delinquency refers to decreased rates of delinquency,

Figure 5. Stakeholders in Home-Ownership Outcomes



default and foreclosure among homeowners in a specific geographic area or with common loan or demographic characteristics. In order to gain support for postpurchase education and counseling, housing-focused organizations must make an explicit link between home-ownership outcomes and postpurchase programs. This link can be forged through research, experimental programs and better outcome measurement.

Public and Private Stakeholders

The analysis of each stakeholder attempts briefly to answer the following questions. First, what are the interests of this type of stakeholder? Second, how strong is the interest of this stakeholder? Third, what link needs to be made between the interests of this stakeholder and homeowner education and counseling programs?

Homeowners

Homeowner needs include building equity, decreasing expenses and inhabiting quality housing. Homeowners are included here as stakeholders for two reasons. First, a strong showing of home-owner demand for postpurchase education and counseling can be one of the strongest drivers of provision of services. Second, like other stakeholders, homeowners are invested in outcomes rather than in the specific programs offered by nonprofits. Providers of these services must articulate the links between program offerings and the needs or interests of homeowners.

The skills and services offered by postpurchase education and counseling can benefit homeowners. Home maintenance skills can allow homeowners to improve the quality, safety and value of housing and to save money on projects. For instance, Neighborhood Housing Services of Toledo estimates that do-it-yourself projects cost one-third what contractors charge. General financial management can prepare homeowners to save and to keep track of income and expenses.

Homeowners have much to lose through delinquency and foreclosure. Homeowners are likely to lose equity and future access to credit as a result. The psychological stress from failing to keep up with mortgage payments or the threat of foreclosure has untold effects on struggling families. For instance, one housing counselor suggested that the causal relationship of divorce leading to mortgage default can work the other way; delinquency can stress the family, leading to divorce.[62]

Neighboring Homeowners

Nearby property owners have a stake in the physical quality of the neighborhood. When homeowners are foreclosed upon, houses may stand vacant for a period of time. This affects the values of nearby homes. For instance, in Rochester, New York, homes sold on blocks with one foreclosed property sold for 14 percent less than homes sold on blocks in the same city ward with no foreclosures.[63] Besides property values, safety and aesthetics are at stake for homeowners living near vacant properties. Proximate homeowners are affected by levels of property maintenance and nearby foreclosures. Their interest in the provision of postpurchase services will depend on how those services affect other outcomes.

Home-Improvement Retailers

Retailers have an interest in outcomes related to property maintenance. Specifically, retailers have an interest in reaching new markets and improving organizational reputation. This interest is significant, since markets for home-related needs are immense. The National Association of Home Builders

[62] Interview with Bill Susan, June 13, 2003.
[63] The Housing Council (2000).

estimates that buyers of new homes spend $8,900 on furnishings and improvements in the first year. Buyers of existing homes spend $7,800.[64] Retailers such as Sears and Home Depot are supporting home-maintenance training through community organizations, suggesting a strong investment in reaching new markets. In addition, publicity about retailer-sponsored classes establishes the name brand and reputation of retailers. Information about the effect of training on consumer choices and firm reputation could help to bolster support for programs.

Building Contractors

Building contractors include builders, electricians, plumbers and other specialists. They are usually small, independent businesspeople. Nationwide, construction contractors capture half of the $120-billion residential remodeling industry.[65] The construction industry as a whole has an interest in the growth of the industry. While contractors do not have an explicit interest in homeowners learning do-it-yourself skills, contractors do stand to gain if trained homeowners gain increased confidence in contracting for services. However, home-improvement classes could have mixed effects on contractors. As a result of sustainability training, contractors as a whole might lose some smaller jobs and the ability to charge high prices to uninformed consumers. On the other hand, informed class participants might feel more confident in hiring contractors for larger jobs. Contractors probably have a limited role to play in supporting sustainability training.

Property and Casualty Insurance Companies

Homeowners-insurance providers manage a wide set of risks. This makes monitoring of homeowners complex. Insurance companies gain if homeowners take precautions against physical property damage from natural causes, homeowner carelessness or loss due to theft. The support of the insurance industry for homeowner-education campaigns suggests strong interest from the industry. For instance, the National Insurance Task Force of Neighborhood Reinvestment has gathered support from multiple insurance firms, trade associations and regulatory agencies.[66] Since insurers typically insure the homeowner against loss, property maintenance and safety rather than mortgage default is the primary concern for property and casualty insurance firms. For the insurance industry to continue to support homeowner education, empirical evaluation needs to be an ongoing part of experimental programs.

Real Estate Agents

Real estate agents direct potential buyers to specific properties. Therefore they have an interest in consumer demand for houses in specific neighborhoods. Insofar as property maintenance and reduced default and abandonment increase housing demand, real estate agents gain from these outcomes. Agents operate on a commission based on the sales price of the house, yet they must expend more effort in neighborhoods where demand for houses is low. Thus the most profitable neighborhoods for agents are those for which there is high demand and high housing prices. When neighborhoods deteriorate, agents may discontinue directing potential buyers to those neighborhoods.

Independent agents have an opportunity to become involved in the revitalization of specific neighborhoods from a business perspective. For example, NHS of Great Falls, Montana, involved real estate agents as part of a revitalization strategy to attract homebuyer attention to specific declining neighborhoods. Interested agents waived the 3 percent listing commission, and many contribute during the organization's annual fund drive. The program has attracted more than 40 agents as partners.[67] The

[64] Joint Center for Housing Studies (2002).
[65] Belsky, Calabria and Nucci (2001).
[66] A list of affiliate partners for the National Insurance Task Force is available at: www.nw.org/network/nationalInitiatives/insurancePartnerships/nat'lInsuranceTaskForce/partnersNITF.html.
[67] See *Winning Strategies: Best Practices in Home-Ownership Promotion,* a publication of Neighborhood Reinvestment Corporation, at www.nw.org.

extent of agent involvement in the Great Falls program suggests that agents could have a minor role to play in comprehensive homeowner education.

Retail Lenders

The "front-end" or retail lending channel refers to originators who resell loans to the secondary market or bundle them into mortgage-backed securities. The significant point here is that mortgage originators who do not hold loans in portfolio have an interest in selling loans but may not have a strong interest in the performance of those loans. This is especially true in the case of third-party originators who are not fully held accountable for the performance of loans that they originate.[68]

Ideally, mortgage originators should meet consistent standards for loans processed, thereby facilitating the eventual performance of loans originated. The secondary market should respond with a sanction of poorer quality originators by paying less to those selling overly risky loans.[69] FHA's Credit Watch, which flags lenders or origination branches producing high-default loans, is designed to improve information to facilitate just such a market response. The embrace of prepurchase counseling by Fannie Mae and Freddie Mac is another market response. However, imperfect information still allows mortgage originators to complete loan sales without paying the full costs for making excessively risky loans.

Depository Institutions

Depository institutions, whether or not they hold loans in portfolio, have added incentive to reach underserved markets as a result of the Community Reinvestment Act. CRA regulators give investment-test credit for grants to community groups and lending-test credit for anti–predatory lending education bundled with the loan.[70] However, CRA credit on the lending test generally accounts more for the origination of loans and less for loan quality and eventual default rates.

Owners of Mortgages

Owners of loans, or mortgagees, include lenders that hold loans in portfolio and investors that buy pooled mortgage-backed securities (MBS). In some cases, the two overlap. For instance, Fannie Mae retains 21 percent of the loans that it buys; another 17 percent are held in the form of MBS. Owners of mortgages experience loss for two reasons. Homeowners may prepay, meaning that they refinance or sell the home, thereby ending the stream of income that the mortgagee receives. The second loss is due to borrower default. Foreclosure is not the only end result from default, nor is it even the most common result. However, foreclosure is the most costly.

While investors or owners generally have an incentive to protect the stream of income paid by homeowners, the incentive should not be overestimated. Investors receive a fixed income stream from MBS. The variability due to delinquency and default is absorbed in part by mortgage insurers, servicers and guarantors. Even in the case of poorly rated subprime loan pools, investors are often guaranteed a fixed income stream. The residual is more likely to be owned by the loan servicer, issuer or guarantor.

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[68] Alexander et. al. (2002) found that loans originated by third parties had higher default rates as compared with similar loans originated by other retail outlets.

[69] In this case, "overly risky" refers to situations in which the loan originator has additional information, not passed on to the secondary loan buyer, that signals that the loan is riskier that it appears from standard information. Classically, this is the case of adverse selection, with the originator having an informational advantage over the secondary market.

[70] See the Interagency Questions and Answers on CRA. Federal Register, July 12, 2001, Vol. 66, No. 134. Available at www.ffiec.org.

Mortgage Insurers

Both government mortgage insurers, such as FHA and the Veteran's Administration (VA), and private mortgage insurers absorb the first layer of loss when borrowers default. Therefore, they have a strong interest in reducing delinquency and default. FHA covers the entire costs of the mortgage plus 75 percent of the costs to the servicer associated with foreclosure. VA covers less than the full outstanding principal. Private mortgage insurance typically covers 20 to 30 percent of the loan. The Minneapolis Housing Fund examined foreclosure scenarios for FHA and privately insured mortgages. They found that HUD could expect to lose $27,000 and private insurers to lose $16,000 on a foreclosure in Minneapolis.[71] A HUD report to Congress estimated that the combined costs of foreclosure to insurers, lenders and servicers ranges from 30 to 60 percent of outstanding loan balance.[72] If education and counseling models can be shown to cost less than the expected losses from default, mortgage insurers will support such programs.

Loan Servicers

Loan servicing is often outsourced by the owner of the mortgage. Even some large nonprofit community lenders such as Chicago NHS and Chattanooga Neighborhood Enterprises outsource servicing on their loans. Although many small loan-servicing firms exist, the industry has grown increasingly concentrated, as noted above in the section on loss mitigation. Loan servicers have direct contact with the borrower, so they are the private sector actor that is best positioned to affect repayment behavior.

Loan servicers have a strong interest in reducing delinquency. The servicer receives either a flat fee or percentage of payment from the mortgage owner. Servicers profit by maximizing the spread between income and costs of servicing. The servicing agreement specifies the range of workout options that a servicer can or must pursue for delinquent borrowers. For instance, servicers of FHA loans must pursue five main workout options before they can start foreclosure.[73] The servicing agreement also specifies the costs that the servicer must absorb. The increasingly prevalent model of loan servicing on risky loans is to pursue workouts aggressively. This suggests that loan servicers have a substantial interest in homeowners sustaining their mortgage commitments.

Incentives paid to servicers for loan workouts with delinquent borrowers give servicers another stake in reducing delinquency and default. Fannie Mae, Freddie Mac and the FHA all provide incentives and valuable waivers of requirements or fees to servicers who are successful in pursuing loan workouts. Freddie Mac even pays servicers an incentive of $100 for workouts that are referred to and performed by Freddie Mac. Freddie Mac offers an additional $100 for loan modifications performed by Freddie Mac on loans with a loan-to-value ratio greater than 80 percent.[74] As suggested above in the section on loss mitigation, servicers may support education and counseling if these can be shown to increase the ability of servicers to reach borrowers and sustain loan workouts.

Guarantors

One role of Fannie Mae, Freddie Mac and Ginnie Mae is to guarantee timely payments to investors. Even if borrowers become delinquent, the two GSEs and Ginnie Mae provide the revenue stream to investors punctually. This translates into an incentive for these organizations to cure delinquencies as rapidly as possible. Guarantors may absorb losses greater than those covered by the mortgage insurer. For this reason, guarantors often issue guidelines to loan servicers that are separate from but similar to guidelines issued by mortgage insurers.

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[71] Moreno (1995). These figures should be viewed with caution, since rapid innovation in financial services has decreased costs of foreclosure.
[72] Capone (1996).
[73] FHA loan servicers must attempt forbearance, modification, partial claim, preforeclosure sale and deed-in-lieu.
[74] See the Freddie Mac Workout Incentive Program Fact Sheet. Available at www.freddiemac.com.

Local Government

Local governments have an interest in increased home ownership, property maintenance and reduced delinquency. Local governments depend on property taxes for revenue. They also incur costs when they must maintain and dispose of abandoned property. The actual foreclosure costs to local governments depends on loan types, lenders and foreclosure and disposition laws. Local governments will have a stake in program delivery if postpurchase education and counseling can be shown to impact default rates and property values.

Besides direct costs of foreclosure, local governments have other interests in sustaining resident investment in home ownership. Many localities market themselves heavily to attract residents and businesses, so the quality of neighborhoods matters. Concentrated property improvement can cause the home prices in a neighborhood to rise, resulting in higher assessed values and taxes. The reverse is also true; deteriorating properties bring less tax revenue to local governments. Governments also benefit when economic activity is stimulated. Home improvements that build healthy neighborhoods and spur economic activity attract residents and capital.

Local governments are often interested in raising home-ownership rates. In part because of research on the effects of home ownership and in part because of common perception that home ownership confers individual and neighborhood benefits, local governments support efforts to bring people into home ownership. State and local uses for Community Development Block Grants include subsidies both for low-income homebuyers and for the development of affordable, owner-occupied housing. The true costs and benefits of home ownership to local governments in the context of local default rates is a topic worth further attention.

VI. CONCLUSION

Conceptual Implications

This section draws four main implications from the preceding analysis. The section recommends (1) education and counseling that is integrated into lending models, (2) education and counseling services that are comprehensive and available both before and after home purchase, (3) research into the effectiveness and costs of homeowner education and counseling, and (4) efforts to build relationships with important stakeholders.

Integrated Models

For postpurchase education and counseling to be brought to scale, they must be *integrated* into the business models of financial services and other industries. While imperfect, prepurchase counseling shows signs of integration into the origination side of the lending industry. Referral mechanisms from lenders to counselors exist. Lenders fund counseling operations even though HUD regulations prohibit a direct fee-for-service model. On the contrary, both sustainability training and delinquency counseling exist as add-ons to the mortgage process. Since these programs have little proven value to lenders, they are not funded or supported by access to information and technology. Moreover, several key gaps currently exist in the loan-servicing market, including the ability to reach delinquent borrowers, the failure rates on loan workouts, and the discrepancy between incentives for the "front" and "back" ends of the mortgage industry. These gaps suggest a need to integrate postpurchase counseling and education into delivery models for lending to underserved homeowners. However, providers need to build capacity quickly in order to work with the rapid innovation and consolidation occurring in the loan servicing industry.

Comprehensive Education and Counseling

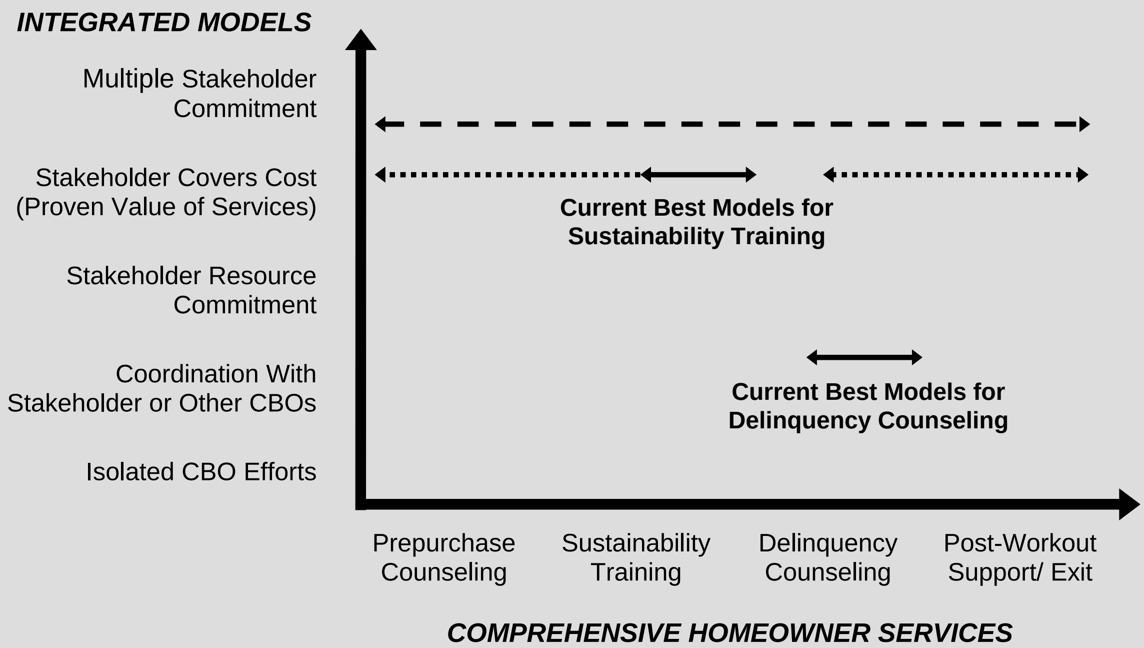
Counseling that is *comprehensive* both before and after purchase would leverage the strength of ongoing relationships to help sustain home ownership. At present, the various components of pre- and postpurchase education and counseling are insular. These need to be connected, since the sum will likely be greater than the parts. For example, the lessons that homebuyers learn in prepurchase counseling fade with time and need follow-up. Stand-alone sustainability training rarely engages the same homeowners that participated in prepurchase programs. Delinquency counseling typically deals with severe cases that mushroomed because no relationship was in place to deal with more moderate problems earlier.

While systems such as NeighborWorks® Full-Cycle Lending® are aiming in the right direction, comprehensive services need to create a full continuum of service available to individual homeowners, rather than a menu of services provided to disparate owners. Furthermore, comprehensive services will be difficult to expand unless they are driven by the business side of the ledger. As previously stated, innovative organizations from all three sectors must step forward to champion pilots.

Effectiveness and Costs

Evaluation is crucial for demonstrating the potential effectiveness of education and counseling when provided systematically. As integrated and comprehensive home-ownership education becomes available, its effectiveness must be documented. Evaluation will be most helpful after successful programs have been brought to scale. While ongoing assessment of pilot programs will help to steer the design of initiatives, broader empirical evaluation will be needed to make the case for incorporating postpurchase education and counseling into business lending models.

Figure 6. Integrated Models and Comprehensive Services



Assessment of costs will help to drive the provision of postpurchase counseling and education. The recommendations presented here would increase costs of lending on the front end through investment in education and counseling. In the long run, however, this may be the most cost-effective way to transact with a subset of underserved borrowers. The prevalent model of lending in the mortgage industry imposes few of the costs of delinquency on loan originators. However, these costs are borne by homeowners and by the back end of the industry through loan default and intensive servicing. These costs ultimately are passed on to borrowers in the form of high interest rates and fees. A comparison of the costs of loan default to the costs of counseling and attendant reductions in delinquency would help to make the case for comprehensive home-ownership education. In particular, costs for delinquent borrowers successfully counseled has been estimated at approximately $3,000. However, it will be important to examine the cost of delinquency counseling that benefits from coordination with loan servicer techniques and information. In addition, such coordination would help to compare the expected costs of loan default (especially with hard-to-reach borrowers) to the costs of outreach and counseling through community-based organizations.

Relationships with Stakeholders

The stakeholder analysis presented here can be used as a guideline for the stakeholders that community-development practitioners should approach. Many housing-focused organizations have relationships with local CRA-regulated lending institutions. Many have relationships with local government. However, most organizations have little or no relationship with large loan servicers or mortgage insurers. For reasons of scale, some of the onus of creating these relationships must fall on national intermediaries and larger organizations. However, CBOs can make efforts to understand, document and approach the stakeholders in their communities.

Business-Model Strategies

This section presents a flavor of how the concepts articulated above might be implemented. The models are listed roughly in descending order of scope, ambition and extent to which they leverage the strengths of education and counseling. The first model is described in more detail; variations are described in subsequent models. This paper recommends that pilots with extensive scope (those listed first) should be the top priority. Tremendous potential exists to use education and counseling to address the seemingly intractable problem of delinquency and default, but the response must be expansive rather than incremental. This paper recommends re-envisioning home-ownership education and counseling as part of a viable business model, rather than as add-ons to the mortgage process.

An important open question is whether nonprofit lenders should attempt to increase in scale in order to bring more services in-house, or whether they should specialize in certain functions and attempt to coordinate with other actors in the mortgage industry. Successful examples exist for both models, but the answer may be specific to individual community organizations, depending on resources, capacity and organizational culture.

Partnership Model of Integrated and Comprehensive Services: Chicago NHS

Chicago Neighborhood Housing Services has been at the forefront of neighborhood revitalization for over 25 years. Through partnership with the city of Chicago, private lenders and community organizations, Chicago NHS has developed a range of comprehensive homeowner services that are integrated with lending practices. In October, 2000, Chicago NHS launched its Home Ownership Preservation Initiative to support struggling homeowners.

Services

- Prepurchase program includes weekly orientation classes, followed by individual counseling and then homebuyer classes.
- First mortgage purchase or purchase/rehabilitation loans with 1 to 5 percent down payment.
- 15 year gap loan (second mortgage) replaces private mortgage insurance.
- Home-improvement and refinance loans that incorporate credit and budget counseling.
- Free Home Safety Evaluations for homeowners through partnership with insurance companies and Chicago Fire Department.
- Postpurchase pilot concentrates in single 90-unit development; 10 monthly meetings offered through partnership with a local CDC and the Chicago Police Department.
- Emergency assistance loan up to $10,000 at 3 percent interest and no closing costs to delinquent borrowers who have resolved underlying issue.
- Neighborhood Ownership Recovery Mortgage Assistance Loan (NORMAL) refinances predatory loans with $2.2 million from 16 lenders, plus $1.2 million from the city of Chicago for operations and loan-loss reserves.

Results

- Over 13,000 loans since 1975.
- Over $1 billion leveraged in Chicago neighborhoods.
- Over 500 Home Safety Evaluations and more than 100 Home Safety Loans closed.
- Over 100 leveraged (87 direct) loans to preserve home ownership through HOPI.
- Of 1,980 requests for HOPI services, 847 (43 percent) workouts achieved.
- Estimated principal savings to homeowners of $72 million.

Source: Chicago NHS Annual Report 2002; proceedings from Home Ownership Preservation Initiative meeting, February 4, 2003; interview with Rochelle Nawrocki Gorey, June 10, 2003.

Model 1: Integrated and Comprehensive Services

Concept

- Contractual relationship between loan servicers, mortgage insurers, originators and collaboratives of counseling agencies.
- Counseling agencies provide prepurchase counseling and scheduled follow-up that includes sustainability training and in-person delinquency counseling if borrowers cannot be reached.
- Delinquency counseling may consist of simply connecting the borrower to the servicer or attempting workouts.
- Counseling agencies provide sustainability training after workouts.
- Evaluation of effects on homeowner satisfaction, financial management, delinquency rates, ability to reach delinquent borrowers and success rates of loan workouts.

Requirements

- Resolve legal issues around contracting with the prepurchase counselor to be used by mortgage originators in the servicer's or insurer's pipeline.
- Increase counseling capacity, including staff, training, access to servicing technology, extended hours of operation and expanded service range.
- Share information, technology and training between servicers and counselors.
- Divide roles between partners and develop understanding of respective operations and competencies.
- Significant resources provided by private-sector partners.

More concretely, this model will require resources, staff capacity and time to prepare. For example, in a pilot currently being run by HUD in Miami, the three participating servicers sent mailings only to borrowers they had not been able to reach. In approximately five months, the servicers sent out a combined 4,500 mailings in Broward and Dade counties. This amounts to an average of 300 unreachable borrowers per servicer per month. In order to limit this volume, a narrow set of loan or borrower characteristics could be selected for a pilot. Ramping up the capacity of counseling agencies will take time and initial investment, perhaps through foundation or municipality support. Prepurchase counseling costs between $100 and $300 per participant.[75] Follow-up would have similar costs. Delinquency counseling has been estimated at $3,000 per successful case; however, this model should significantly decrease that amount.[76]

Possible actors, strengths and roles

- HUD: Solicit FHA loan servicers and counseling agencies; initial investment in counseling-agency capacity through grant program.
- State housing finance agencies: Leverage relationships with community groups; coordinate functions of originators, counselors, servicers and insurers.
- FHLB: Leverage relationships with member banks; draw from current innovations among member banks; coordinate loan servicers and navigate legal issues with investors.
- Rural Development: Leverage ties to community groups in rural areas; integrate counseling into internal loan servicing.
- Private mortgage insurers and servicers: Use risk tools to identify appropriate population of loans for pilot; offer private-sector flexibility to experiment; leverage relationships with originators.
- Local government: Facilitate the formation of regional counseling collaboratives; secure facilities, access to information and in-kind contributions.

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[75] Collins (2002).

[76] The Minneapolis Housing Fund estimated that the cost of reinstating mortgages was $3,300 for both counseling and financial assistance, based on total program costs divided by number of counselees reinstating (Moreno 1995). Coordinating roles between loan servicers and delinquency counselors would likely decrease that amount.

- National or regional community-development intermediaries: coordinate community-based organizations; design curriculum and training; bridge sectors.

Location

The pilot should be located where counseling capacity is already at high levels from ongoing organization and funding. For instance, Pennsylvania might lend itself to such a pilot. Location choice would depend on the character of the state and local government as well. The ideal location to test a comprehensive model would be one where the local government currently plays an active role in

In-House Model of Integrated and Comprehensive Services: Neighborhood Assistance Corporation of America (NACA)

NACA is best known for its aggressive tactics in confronting lending institutions. At the same time, NACA runs a mortgage lending program with $6.7 billion in lender commitments. NACA operates through 26 local offices and integrates comprehensive education and counseling into its lending operation.

Loan Product
- Purchase mortgage at 1 point below market rate for 1- to 4-unit homes.
- No down payment, closing costs or private mortgage insurance.
- Individual budget used instead of conventional debt and housing ratios.
- $50 monthly payment to Neighborhood Stabilization Fund (NSF).
- Pledge to participate in NACA advocacy.

Housing Services
- All services free to homebuyers and homeowners.
- Initial prepurchase workshop initiates several-month process.
- Buyer's agent to represent buyer in purchase-contract negotiation.
- Final NACA Credit Access approval of buyer before loan closing.
- Postpurchase workshops on budgeting, property-tax abatement, home maintenance and landlord issues.
- Short-term mortgage assistance available through NSF; assistance award decided by homeowner peer committees.

Borrower Profile
- Three-quarters of borrowers have FICO score below 660; 56 percent have scores below 620.
- 66 percent low-income families.
- 70 percent of NACA borrowers have less than $5,000 in savings.
- Almost 90 percent of borrowers are minority.
- 41 percent single heads-of-household.

Results
- Over 10,000 NACA mortgages since 1988.
- 99.75 percent of borrowers still in home and paying mortgage.
- Negligible losses due to default or prepayment.
- Bank of America rated NACA "level A" for services and operations; Bank of America committed $3 billion to NACA mortgage lending.
- 98 percent of Bank of America borrowers in NACA program stated they would use Bank of America again for financial services.

Source: Interview with Bruce Marks, CEO (August 12, 2003); "Reinventing Mortgage Lending: The NACA Program." Information available at www.naca.com.

sustaining home ownership. Finally, it would be helpful to test pilots across regional economies to determine what circumstances can be addressed by education and counseling.

Model 2: Integrated Delinquency Counseling

Concept

- Contractual relationship between loan servicers, mortgage insurers and collaboratives of counseling agency (excludes originators).
- Counseling agencies provide welcome call on loan entry into servicer's portfolio.
- Counseling agencies provide on-demand sustainability training and delinquency counseling in person if borrowers cannot be reached.
- Counseling agencies provide sustainability training after workouts.
- Evaluation similar to model 1.

Requirements

- Similar to model 1, excluding prepurchase counseling and contractual relationship with originators.
- If counselors are not part of the contract from origination, legal or contractual means must be devised to allow counselors to access borrowers before delinquency occurs.

Roles

- Similar to model 1, with greater emphasis on "back end" of lending industry.

Model 3: Targeted Delinquency Counseling Intake

Concept

- No contractual arrangement.
- Information-sharing agreements between counselors and loan servicers.
- Triage based on borrower position and track record of loan servicer.

Requirements

- Information clearinghouse of the mortgage insurer and loan servicing firms made available to counselors, including track record, loss-mitigation policies and loan-workout models.

Roles

- Less intensive role for lending industry. National intermediaries and HUD can facilitate the flow of information to delinquency counselors.

Model 4: Greater Role for One-Stops for Existing Homeowners

Concept

- Single location for current homeowners to access information and services.
- Comparisons and contact information for a range of products and industries relevant to home ownership, including information on abusive loans.
- Services available, including rehabilitation or emergency loans, sustainability training and delinquency counseling.

Requirements

- Coordination of multiple industries and postpurchase topics.
- Availability of both a drop-in and classroom format.
- Explicit safeguards against steering homeowners toward specific products or businesses.

Roles

- Home-ownership–related industries can offer expertise in their product areas, marketing assistance and resources for class delivery.
- Local governments can assist in establishing the facilities and visibility of one-stops.
- National intermediaries can design, market and support one-stops.

Model 5: Create an Affordable Loan Product That Bundles Sustainability Training

Concept

- Loan product that requires both prepurchase education and sustainability training after purchase.
- Counselors possibly available to contact hard-to-reach delinquent borrowers.

Requirements

- Some increased capacity and consistency, especially in sustainability training.
- Quality curriculum and incentives such as lump sum (perhaps the final installment of closing cost assistance) or a reduction in interest rate to induce homeowner participation.
- A ballpark figure for the cost of sustainability training is $500 for a 10-week training.[77]
- Evaluation similar to model 1.

Roles

- Product offering through large-volume lenders or insurers, including the GSEs or state HFAs.
- National intermediaries can support consistency and quality of counseling delivery.

Figure 7. Scope of Suggested Models

Characteristics	Model 1: Integrated and Comprehensive Services	Model 2: Integrated Delinquency Counseling	Model 3: Targeted Delinquency Counseling	Model 4: Homeowner One-Stops	Model 5: Bundled Loan and Coun-seling Product
Prepurchase counseling	Yes	No	No	Possibly	Yes
Sustainability training follow-up	Yes	Yes	No	Yes	Yes
Delinquency counseling	Yes	Yes	Yes	Possibly	No
Contractual	Yes	Yes	No	No	Possibly
Stakeholders involved	■ Originators ■ Loan servicers ■ Mortgage insurers ■ Local government	■ Loan servicers ■ Mortgage insurers ■ Local government	■ Loan servicers ■ Local government	■ Retailers ■ Property insurers ■ Local government	■ Secondary market or portfolio lenders

[77] Based on costs reported by NHS of New York City for home-maintenance classes. Available in the publication *Winning Strategies: Best Practices in Home-Ownership Promotion,* a publication of Neighborhood Reinvestment Corporation, at www.nw.org.

Policy Recommendations

There are several roles for policymakers and policy-setting agencies in making these changes. First, federal and state agencies may be able to initiate models that carry high start-up costs or risks. Second, policy agencies can improve the flow of information. Third, public policy can clarify the legal foundations for various initiatives. This section provides general recommendations for policy changes beyond the specific pilots listed in the previous section.

Increase Capacity of Counseling Agencies

HUD and other public owners and insurers of mortgages should play a strong role in coordinating counseling with loss mitigation. For example, delinquency counselors should be able to access detailed online information about FHA, state HFA, FHLB and GSE loan servicers and servicing agreements. These actors should encourage loan servicers to make workout technology available on-line or in simple spreadsheet format. Delinquency counselors could then quickly assess the quality of servicer workouts with borrowers.

HUD, state HFAs, foundations and national intermediaries should target funding specifically to delinquency counseling based on the volume and difficulty of cases. Current funding most typically offers a lump-sum grant to counseling agencies. This does not provide an incentive for counseling agencies to increase capacity according to community needs. A steady funding source on a per-counselee basis could spur increased capacity.

HUD should clarify conflict-of-interest provisions in its guidelines for housing counseling. Many innovative approaches require partnerships between nonprofits and industries. HUD's conflict-of-interest clauses seem written to address prepurchase counseling. The rules need to be clarified as they relate to delinquency counseling and other postpurchase services.

Examine Incentives to Loan Servicers

Loan servicers are the actors in the mortgage industry who are best positioned to affect borrower repayment behavior. Loan servicers have an incentive to maximize the spread between servicing fees and costs. In broad terms, default and foreclosure are costly to servicers, resulting in servicer incentives to pursue loan workouts with delinquent borrowers. However, these incentives should be subjected to closer scrutiny. It is unclear how servicers trade off various costs and benefits from late fees to delinquent borrowers, and there is uncertainty about workout success and duration, and resale of servicing rights. The analysis and recommendations of this paper rest on the premise that the mortgage industry collectively has a strong incentive to prevent foreclosure and to keep delinquent borrowers in their homes when possible. However, future research should examine the extent to which the overall mortgage industry incentive translates into incentives for individual loan servicers.

CRA Credit

Lenders currently receive CRA credit for grants to CBOs and for the inclusion of anti–predatory lending education in loan origination.[78] Regulators could give increased emphasis to lender efforts to integrate education and counseling into servicing activities. Since lenders are well positioned to analyze loan-performance data, regulators could extend CRA credit to lenders who rigorously evaluate the effectiveness of education and counseling. Lenders could also receive credit for making data available for study.

[78] For example, see the "Interagency Question and Answer" on CRA regulation, available at www.ffiec.gov (Federal Register Vol. 66, No. 134, July 12, 2001).

Challenges Ahead

The fortuitous confluence of interest in sustaining home ownership between homeowners, counselors and various industries has limits. The broad alignment of interests belies smaller-scale divergence of interest. For instance, mortgage insurers and servicers are interested in reducing delinquency rates, but they may not be interested enough to reduce interest rates and fees or to refer homebuyers to the most competitive product available. Certain retailers are interested in developing the home maintenance skills of homeowners, but this is motivated by an interest in expanding sales — which may run counter to the interests of some homeowners. Despite these countervailing interests, increased coordination between industry and community organizations may hold part of the key to sustaining home ownership.

For partnerships to move forward, several obstacles must be confronted. First, nonexistent or adversarial relationships often mark the interaction between delinquency counselors and loan servicers. In contrast, many housing-counseling agencies and development organizations have positive relationships with the "front-end" retail lenders in the mortgage industry. These relationships need to be explored through dialog between stakeholders. Second, the styles of nonprofits and firms can be very different. Many nonprofit housing agencies would not be interested in adopting the tactics of private collection agents. Similarly, nonprofits do not want to become salespersons for home-ownership–related industries. At the same time, private firms have little patience for time-intensive or highly individualized approaches to supporting homeowners. Any partnership needs to recognize the legitimate roles of multiple approaches. Third, homeowners need a continuum of services, yet many stakeholders are interested in narrow components of education and counseling. Developing models that are integrated with the private sector will require significant coordination from actors such as intermediaries, foundations and industry associations. Finally, talk about new models must be backed up by a real commitment of resources. Incremental approaches that fund only small fractions of a comprehensive home-ownership education system will not leverage the strengths of education and counseling in addressing home-ownership sustainability. These challenges must be explored as a precursor to the development of integrated and comprehensive models of postpurchase education and counseling.

GLOSSARY OF SELECTED TERMS

Deed-in-Lieu The agreement by a delinquent borrower to give the deed to the property to the lender in place of foreclosure proceedings. Usually, the borrower is released from responsibility for any shortfall between the loan amount and the selling price of the property.

Delinquency Counseling As used in this paper, the efforts of a nonprofit, community-based counselor to assist a borrower in delinquency. This includes a diagnosis of the problem, assessment of the borrower's ability to cure the delinquency and negotiations with the loan servicer.

Forbearance The agreement by a lender to suspend collection of mortgage payments for a finite period of time.

Foreclosure The decision by the lender to exercise the legal right to obtain a collateralized property when the borrower has defaulted on the obligation to repay the loan.

Government-Sponsored Enterprise (GSE) Private entities that have implicit or explicit backing and mandates from the federal government. These include the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal Home Loan Bank System (FHLB).

Guarantor Entity that guarantees the punctuality of the stream of payments to investors in bonds or securities backed by mortgage loans.

Intermediary Also Community Development Intermediary. National or regional organization that assists community-based organizations through grants, loans, technical assistance and networking.

Loan Assumption The agreement by a third party to take over loan payments for the borrower.

Loan Servicer Firm or organization that services the loans for the owner or investor of the loan. Depending on the details of the servicing agreement, the loan servicer may be responsible for collections, attempting to cure borrower delinquencies and processing foreclosures. The servicer also shoulders costs as contracted in the servicing agreement.

Loan-to-Value (LTV) The ratio of the amount of unpaid principal on the loan to the value of the underlying asset.

Loss Mitigation The attempt by financial institutions to find less costly alternatives to foreclosure. Alternatives may or may not keep the borrower in the home.

Modification A change in loan terms, such as principal, interest or maturity period. Usually performed to assist a delinquent borrower.

Mortgage Delinquency Technically, the condition when a borrower is past due on a mortgage payment. In practice, a borrower is usually considered delinquent only when a payment is 30 days past due.

Mortgage Default Generally used to mean the point at which a borrower is 90 days past due. At this time, the borrower has missed three payments and a fourth is due. Most states will consider a foreclosure petition from the lender at this time.

Mortgage Insurance An insurance product that covers the owner/investor of the loan if the borrower defaults. Mortgage insurance is paid through fees charged to the borrower. Private mortgage insurers typically cover 20 to 35 percent of loan value, whereas the Federal Housing Administration covers 100 percent.

Negative Equity The condition in which the outstanding principal on a loan is greater than the value of the underlying asset.

Preforeclosure Sale The voluntary selling of a property by a delinquent borrower to repay the loan amount due. Usually, the borrower is released from any shortfall between the value of the loan and the selling price of the property.

Portfolio Lender A lender who retains ownership of loans rather than selling them to other financial institutions or investors. In some cases, portfolio lenders retain loans for several months so that the loans demonstrate their creditworthiness.

Secondary Market Collectively, institutions that repurchase loans from originators. Institutions of the secondary market include Fannie Mae, Freddie Mac, the Federal Home Loan Bank System, firms that securitize home loans and investors that purchase mortgage-backed bonds or securities.

Servicing Rights The contractual agreement between an entity and the owner/investor of the loan that entitles the entity to a servicing fee from the owner. The servicer has the responsibility of regular contact with the borrower for the purpose of collections. Servicing rights can be bought and sold independently from the loan itself.

Sustainability Training As used in this paper, homeowner education that occurs after home purchase and that delivers skills and information to homeowners relevant to financial and home-maintenance obligations.

Trigger Event A personal economic event that renders a borrower unable (or possible unwilling) to make mortgage payments. Common trigger events include loss of employment, divorce, illness and death in the family.

Unsecured Debt Debt that is not backed by an underlying asset. Commonly refers to consumer debt in contradistinction to debt that is secured by the value of a real estate property.

Workout An agreement between the loan servicer and borrower that results in either the borrower curing a delinquency or terminating tenure through means other than foreclosure. Some lenders include repayment plans as a type of workout.

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www.cdcli.org

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Neighborhood Reinvestment
www.nw.org/network/nationalInitiatives/insurancePartnerships/nat'lInsuranceTaskForce/nitf.html

NeighborWorks® Full-Cycle Lending®
www.nw.org/network/nationalinitiatives/campaignforhomeownership02/whatwedo/fullcyclelendingsm.html

Neighborhood Housing Services of New York City
www.nhsnyc.org/education.html

Research Institute for Housing America
2001 Conference on Housing Opportunity: "Smart Enough to Sustain Homeownership?"
Presentation by Larry Cordell, Director of Information Engineering, Freddie Mac
PowerPoint available at www.housingamerica.org/downloads/web4.ppt

Saint Ambrose Housing Aid Center
Mortgage Delinquency Counseling
www.stambros.org

Sears American Dream Campaign[SM]
Partnership with Neighborhood Reinvestment
www.nw.org/network/sears/web/index.html

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