Joint Center for Housing Studies

Harvard University

Strengthening the Case for Homeownership Counseling: Moving Beyond "A Little Bit of Knowledge"

Steven P. Hornburg

December 2004

W04-12

Support for this report was provided by the Neighborhood Reinvestment Corporation

© by Steven P. Hornburg. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Steven P. Hornburg is a principal at Emerging Community Markets and a housing finance and policy consultant, with over 20 years of experience in national housing policy and mortgage finance. His current work covers issues involving affordable housing, housing finance, homeownership education and counseling, community development, fair lending, smart growth finance, and HUD programs. The author acknowledges and wishes to thank the Neighborhood Reinvestment Corporation for providing funding for this paper.

Any opinions expressed are those of the author and not those of the Joint Center for Housing Studies of Harvard University or of any of the persons or organizations providing support to the Joint Center for Housing Studies.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Introduction

The announcement of the NeighborWorks® Center for Homeownership Education and Counseling (NCHEC) presents a legitimate and appropriate opportunity to assess what the research literature on homeowner education and counseling (hereafter referred to as "counseling"[1]) suggests about the efficacy and impact of counseling. The answer will have further value with the release of pricing data in the 2004 Home Mortgage Disclosure Act data (HMDA) and the continued seasoning of highly leveraged affordable loans and rising interest rates.

There has not been a comprehensive review of the literature since 2001[2], and new research has emerged since that time. Furthermore, greater diffusion and application of technology, further industrial consolidation, public policy developments, and a changed economy may reframe the context in which counseling is considered.

This paper reviews the current modern literature, including the very limited body of research on the effectiveness of counseling. While there is earlier literature on counseling from the 1960's and 1970's, this literature will not be reviewed, as its relevance is questionable and both the mortgage and counseling industries have radically changed since the conduct of these studies.[3] Findings from this literature on counseling will be condensed to key points that can be said with confidence. Additional and emerging research not directly related but relevant to homeownership counseling will be discussed.

Finally, the paper will examine the unanswered questions about homeownership education and counseling. Key considerations for ongoing research will be outlined.
Some important caveats about this review are in order.

---

[1] This author recognizes that there are a variety of relevant and important distinctions that frame nonprofit homeownership counseling. Some dimensions include the timing (pre- versus post-purchase), pre-purchase approach (self-directed, group education or training, and one-on-one counseling); post-purchase approach (general education versus delinquency/foreclosure prevention); and lastly, the type (homeownership versus credit counseling or financial literacy). Finally, while businesses offer a significant amount of pre-purchase homeownership counseling, most of it is by telephone (McCarthy and Quercia 2000), an approach of questionable effectiveness (Hirad and Zorn 2001). For the purpose of this review, the term "homeownership counseling", and "counseling" refer to the various strains of pre-purchase homeownership counseling offered by nonprofits. See Quercia and Wachter (1996), McCarthy and Quercia (2000), and Gwatkin and McCarthy (2003) for excellent discussions of typology.

[2] Mallach (2001).

[3] See Straus and Phillips (1997) and Mallach (2001) for more detailed discussions and citations for this earlier literature.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

- This paper mainly reports the findings of the papers reviewed. While few are actually formal research papers, this review does not purport to formally review the research methodology used in these papers.
- To the extent that there are credible and substantiated research findings about homeownership counseling, they are about loan performance. While credible findings about other impacts of homeownership counseling would be welcomed, they do not exist in the literature reviewed here.
- Research on related topics, including consumer attitudes, behavior and financial literacy do offer credible research findings that are relevant to homeownership counseling, and are therefore included.
- For the most part, the literature on homeownership counseling included here focuses on pre-purchase and not post-purchase counseling.[4]
- Finally, some questions about the impact of homeownership counseling can and should be grounded in the broader research literature on mortgage default and the costs and benefits of homeownership. These topics are beyond the scope of this review, but see Capone 2002 for a solid, accessible discussion of the default literature and see Rohe 2001 for an excellent overview of the literature on the social costs and benefits of homeownership.

Homeownership Counseling in a Broader Context

The homeownership counseling industry exists in a rapidly changing and growing financial services industry.[5] The last decade has seen the development of an increasingly specialized and segmented financial services market offering an explosion of choice and options, but requiring a far savvier consumer to safely navigate those choices. Technology advancements drove major changes in marketing to consumers, shopping for products and services, product offerings and underwriting decisions for a variety of financial products. In addition, the industrial organization of financial services underwent rapid changes, including consolidation, changes in geographic boundaries and deregulation (reflecting and encouraging expanded product offerings by financial services institutions). Of particular interest to the housing

[4] There is, however, research benchmarking post-purchase counseling being developed. See Baker (forthcoming).
[5] This discussion draws on an excellent summary of the overall market context of the financial services industry (Braunstein and Welch 2002).

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

community, the long-recognized inaccessibility of mainstream services and institutions to underserved populations gave rise to a major increase in alternative, or fringe, providers of financial services, particularly in distressed communities.[6]

In tandem with--but not necessarily because of--these changes, some trends in consumer finance have been troubling. As many anecdotal examples demonstrate some research has suggested predatory lending practices, long a simmering problem, have become more visible and prevalent. Some mortgage market players take advantage of borrowers by marketing loan products with pricing, terms, and conditions that do not reflect the true risk of the borrower's circumstance. In more extreme cases, these practices include illegal misrepresentations about loan characteristics, and loans characteristics programmed to induce default and foreclosure. Furthermore, consumer debt has increased to levels many find troubling. Non-business bankruptcy filings have increased. And personal savings rates, already low in the United States compared with other countries, have further declined. The massive shift in employer pension funds--from defined benefit plans to defined contribution plans--transferred more responsibility for household's retirement options from employers to their employees.

The increasing diversity and foreign-born population is another key trend raising concerns about consumer financial literacy. While strides were made, concerns remain regarding discrimination in the housing and mortgage markets. Substantial academic and policy debates occurred over whether racial and ethnic differences in homeownership and loan denial rates represent discrimination.[7] Yet gaps suggest that more progress can be made. Furthermore, the increase in foreign-born populations raises issues of unfamiliarity with American financial institutions and practices, as well as cultural, educational, and language barriers.

These trends and factors contributed to an explosion in consumer financial literacy programs, broadly defined. While financial literacy programs have a long history, research commissioned by the Fannie Mae Foundation found that three-fourths of programs surveyed were started in the late 1990s or 2000 (Vitt *et al* 2000). Braunstein and Welch (2002) highlight the diverse providers of financial literacy programs, including banks, employers, the military, faith-based organizations, nonprofits, community colleges and state cooperative extension services. Motivating these organizations are interests such as expanding markets, generating

[6] For an excellent discussion and analysis of these trends, see Carr and Schuetz (2001).
[7] See, for instance Ross and Yinger 2002.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

good will, service provision for members and employees, public service and favorable regulatory treatment. These programs have a wide range of content, audience, goals, and program scope.

Evolution of Homeownership Counseling: The First Two Decades[8]

The research literature reviewed all trace the modern emergence of a homeownership counseling industry to the late 1960s, when federal housing subsidy programs—notably the Section 235 homeownership program—was enacted. Starting with simply authorizing organizations to provide counseling to borrowers under the federally subsidized homeownership programs, federal legislation gradually expanded the allowable activities and organizations under approved counseling programs. In particular, the massive and concentrated foreclosures under the Section 235 program focused the emergent counseling industry mainly on delinquency and foreclosure prevention.[9]

Interestingly, while federal legislation expanded the organizations authorized to provide counseling, Congress did not authorize funding for the industry until the 1974 Housing and Community Development Act. Initially funded at $3 million in the FY76 appropriation, funding quickly rose to a high of $9 million in the FY79 and FY80 HUD appropriations,[10] before rapidly tapering to around $3 million again for most of the 1980s.[11] Mallach (2001) argues that federal funding and interest generally dropped off as the Section 235 problems were worked out.

Strauss and Phillips (1997) present an excellent examination of the literature from the early years of the homeownership counseling industry's experience, summarizing and critiquing 11 studies on the impact of counseling. Their review found an industry predominantly engaged in post-purchase delinquency and foreclosure prevention, and one whose impact was ambiguous at best. Strauss and Phillips, in their research, and Mallach, in other research, conclude that severe methodological flaws and data limitations compromised the mostly ambiguous findings this body of research produced. Quercia and Wachter (1996) go further to point out that innovations in loan servicing and loss mitigation, combined with these methodological flaws, render these studies irrelevant to today's post-purchase counseling environment.

---

[8] This discussion draws on a number of papers reviewed in this article, including Quercia and Wachter 1996, Strauss and Phillips 1997, Mallach 2001, and Hirad and Zorn 2001.

[9] See Carliner 1998, for instance.

[10] Tracking what Mallach (2001) characterized as the institutionalization of counseling industry due to the massive defaults associated with the Section 235 program.

[11] OMB 2004.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Evolution of Homeownership Counseling: Phase Two

While industry and public policy enthusiasm for homeownership counseling flagged in the 1980s, the decade of the 1990s saw a renaissance of interest. For the HUD homeownership counseling program, funding remained around $3.5 million until 1991 when program funding increased and peaked at $12 million through the mid-1990s. The program then ramped up further, to an appropriated level of $40 million by 2003.[12] The Administration's budget proposed a funding level of $45 million for the next fiscal year.[13] The current program funds a variety of pre- and post-purchase counseling, supporting a variety of HUD programs, such as FHA 100 percent financing and Home Equity Conversion Mortgages, anti-predatory lending efforts, the Colonias initiative and Section 8 homeownership vouchers. The bulk of support—over 70 percent the last two fiscal years—flows through national nonprofit intermediaries and local housing counseling groups. The proposed funding for the next fiscal year will serve close to 800,000 individuals and families, an increase of about 100,000 over current levels. In contrast to the first two decades, most of the activities supported now focus on pre-purchase counseling.[14]

While HUD funding for counseling increased over the 1990s, most observers trace this decade's renewal of interest to reinvigorated enforcement of the Community Reinvestment Act and the enactment of affordable housing goals for Fannie Mae and Freddie Mac. The latter legislation led to Fannie Mae and Freddie Mac substantially ramping up their affordable lending efforts. Both of these requirements gave lenders new incentives and products with increased underwriting flexibilities to reach underserved households and communities with modified or new products. This stretching of traditional underwriting criteria by Fannie Mae and Freddie Mac was accompanied by the addition of a counseling requirement to their affordable lending products in 1993. This led to an explosion in the number, approaches, funders, and providers beyond the traditional HUD homeownership counseling industry.

The homeownership counseling industry of today is a highly diverse group of agencies loosely affiliated with a number of nonprofit intermediaries, trade associations, and various sponsors. Multiple funding streams from the government, foundations, and the industry fuel this

---

[12] Ibid.
[13] HUD 2004.
[14] Rohe 2001.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

diverse segmentation.[15] As noted previously, homeowner counseling has a specialized role in a broader array of financial literacy and credit counseling programs. But within that niche, lightly regulated industry development encouraged a wide spectrum of approaches, which may be good for experimentation and adaptation to local circumstances.

Industry at a Crossroads

Nevertheless, the homeownership counseling industry is at a crossroads. The mortgage market has radically changed and originations are dominated by risk-based pricing driven by automated underwriting. Servicing also is increasingly driven by technology. And while predatory lending practices have consumed an enormous amount of attention and effort, the legitimate subprime market is maturing and offering fair options to many borrowers previously shut out of the prime market. Consumers are presented with a dazzling array of product options, and the rise of the Internet has brought the application process into the digital age. In this context, we explore what insights modern research literature has to offer about homeownership counseling.

Studies

Quercia and Wachter (1996)

During a period of massive new investment to promote homeownership, Roberto Quercia and Susan Wachter were presented a question: how does one judge success in homeownership counseling?[16] In response, they outlined a fundamental lack of knowledge about how homeownership counseling performed, let alone be measured. They offered a new definition of a successful counseling program, combining the twin goals of promoting homeownership with reducing default. In particular for a counseling approach to be successful it must help homebuyers "…with a low long-term probability of ownership"[17] adding a more targeted criterion designed to sort out interventions that simply speeded up the homebuying process for a household.

[15] See Shabecoff 1994 for an excellent decomposition of the segmented structure and funding of the homeownership counseling industry.
[16] As managing editor of *Housing Policy Debate,* this author framed the question and sponsored this paper.
[17] Quercia and Wachter 1996, p. 175.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Quercia and Wachter provided the first published literature review on the previous 20 years of research on the efficacy of homeownership counseling.[18] Their real contribution was providing a research framework to guide future research on impact of homeownership counseling. Their definition of a successful counseling intervention solidly embeds measuring impact firmly in research literature on why a consumer decides to buy a home (tenure choice) and why a homeowner fails to pay their mortgage (default decision). In these areas, the research literature is well developed and frames the ongoing development and refinement of mortgage underwriting criteria. Framing the question of impact in mainstream research eases the challenge facing future researchers.

Based on this literature, Quercia and Wachter suggest mechanisms by which counseling could affect tenure choice and default decisions. Counseling can affect tenure choice by encouraging people, who felt they could not get a mortgage, to consider the possibility and position themselves to qualify. Skills taught in counseling programs, such as budgeting and advocacy by counselors, could help people qualify for a loan. Counseling can affect the default decision by helping potential borrowers most at risk to opt out of homeownership. The same skills taught in counseling that help borrowers qualify also may increase the likelihood of successful budgeting and debt repayment, as well as prepare participants to navigate and head off potential crises and avoid default.

Quercia and Wachter proceed to provide a recommended approach to empirically test the impacts of counseling, developing a model that also incorporates key determinants of homeownership and default decisions. The specifics of their recommendations (research design, sample selection, variables, measurement and statistical analysis) are eight years old and may benefit from an update, but their proposed approach still stands as a benchmark by which counseling impact research can be judged.

Strauss and Phillips (1997)

Strauss and Phillips report on an extensive set of interviews with rural housing counseling providers. After finding no literature directly addressing rural housing programs, they reviewed the existing literature—11 studies—in detail and find that it generally suggests a

[18] Their review was based on two previous unpublished or draft reports (Housing Assistance Council 1994, eventually published as Strauss and Phillips 1997, and Shabecoff 1994) that directly reviewed and critiqued the 11 previous empirical studies on homeownership counseling.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

positive effect. However, the studies vary in the outcomes they evaluate, and the intensity of the effect ranges from slight to major improvements. However, Strauss and Phillips found no consensus among the 11 studies, and discovered serious methodological issues in all the studies that raise questions about their reliability.

In framing their interview findings, Strauss and Phillips identified a variety of circumstances that distinguish the rural context from more urban counseling programs. With sparse populations spread over large areas, access to programs is difficult, especially with a lack of public transportation. Smaller rural populations encourage close personal relationships that some studies, they reviewed, suggested were more effective for counseling.

Rural economies tend to be more concentrated and subject to the fortunes of a single, large employer or type of business, concentrating the risk of unemployment. While home prices are lower, so are incomes in rural areas. And as the case with public transportation, the coverage of the social services network and financial institutions is spottier. While nationally the housing stock has improved, rural areas still disproportionately suffer from housing quality problems. Finally, rural areas often have populations with special cultural needs (Native Americans, for instance).

Strauss and Phillips placed the counseling programs they surveyed in this unique rural context. Ultimately, they found that the providers they interviewed have a firm belief in the efficacy of homeownership counseling, from their experience, even though most did not collect data that could prove their beliefs. Further, these providers feel the qualitative effects of value are present that are not captured by mere numbers. Strauss and Phillips conclude by observing the difficulty in disentangling the effects of counseling from the other aspects of these organizations' work, such as flexible underwriting and deep mortgage interest subsidies.

McCarthy and Quercia (2000)

George McCarthy and Roberto Quercia were posed the question: in the absence (at that time) of any empirical evidence of the impact on loan performance, why was the mortgage industry heavily investing in homeownership counseling?[19] The authors point out perhaps the biggest practical challenge facing any attempt at a broad assessment of the industry's impact:

[19] As executive director of the Research Institute for Housing America, this author framed the question and sponsored this paper.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

> One reason for the dearth of good empirical evidence on the efficacy of the HEC industry is the high degree of diversity among programs. The industry is fragmented due to a large variety of HEC providers offering qualitatively and quantitatively different homeownership training. The unregulated evolution of the HEC industry, while promoting experimentation and creative approaches to expanding homeownership, has made it difficult to evaluate its effectiveness. [20]

Why then, did the mortgage industry's investment in homeownership dramatically increase in the 1990s in light of no systematic body of research that convincingly demonstrates that homebuyers receiving counseling are less likely to default on their mortgages?

A potential resolution of this contradiction emerges when the various roles played by nonprofit counselors in the home buying process.[21] These providers simultaneously meet several mortgage industry needs. They can:

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

As the authors point out, while the amount of funds invested by the industry look large to the nonprofit community, this investment is miniscule compared to the amount of money flowing through the housing finance system. The authors believe these functions of nonprofit homeownership counselors may explain the phenomenal growth of investment in the 1990s. But, they caution, to secure funding that can sustain the industry over the long haul, the value proposition of counseling in reducing default and foreclosure costs must be clearly and convincingly demonstrated.

[20] (McCarthy and Quercia 2000, p. 3)

[21] The rest of this discussion is drawn from the Institute Perspective written by this author that introduces the McCarthy and Quercia publication.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

McGilvray (2000)

A key element of the American Homeowner Education and Counseling Institute (AHECI)[22] was to build the knowledge base on the impact of homeownership counseling on loan performance. AHECI commissioned Price Waterhouse Coopers to conduct a cost-benefit study on this topic. This effort foundered and was ultimately unsuccessful. Why this effort foundered is as critical to the evolution of homeownership counseling as if the study was successful. In 2000, Margaret McGilvray presented the case history of the study at a conference on homeownership counseling sponsored by the Research Institute for Housing America.[23]

In 1999, Price Waterhouse Coopers surveyed data availability from a sample of founding organizations of AHECI that were also financial institutions.[24] They used a questionnaire and a series of in-depth interviews to determine if those institutions had the prerequisite data for Price Waterhouse Coopers to conduct a cost-benefit study. The results of this survey stopped the project in its tracks.

What McGilvray and her colleagues found was that none of the institutions tracked homeownership counseling data by borrower. Furthermore, the counseling requirements were linked to specific products, making design of a control group difficult. McGilvray cited the restriction of counseling requirements to low-income borrowers, combined with exceptions permitted in those categories, undermined Price Waterhouse Coopers' ability to conduct the study. The survey revealed variability across institutions in the type, format, provider, and delivery of counseling.

Price Waterhouse Coopers identified additional issues involving a lack of or inconsistent data collection by lenders and servicers that are more industry wide. The survey also identified

---

[22] According to McCarthy and Quercia 2000, "Fannie Mae initiated the American Homeowner Education and Counseling Institute (AHECI) in 1996. It was Fannie's hope to bring together a comprehensive group of industry stakeholders to establish both national curricular guidelines and certification standards. Fannie invited other GSEs, large lenders, mortgage insurers, Realtors®, national and local housing nonprofits to participate in the effort.
AHECI was established to accomplished five goals:
• To establish national accreditation standards for providers of HEC;
• To develop a core curriculum for HEC;
• To research the costs and benefits of HEC;
• To establish the means for self-financing of HEC initiatives;
• To establish an informational clearinghouse for HEC materials and methods."
AHECI recently ceased operations, leading the Neighborhood Reinvestment Corporation to develop the newly announced NCHEC initiative.

[23] To view a video stream of the proceedings and materials prepared for the conference, see http://www.housingamerica.org/agenda.html.

[24] See McCarthy and Quercia, p. 21 for a list of Founding Members of AHECI.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

that some financial institutions that had multiple databases that they would have to access to provide the data. Variations in organizational structure meant that some financial institutions had a centralized point of contact for gathering the data, while others required multiple contacts to different divisions. In sum, Price Waterhouse Coopers argued that the study was essentially undoable.

Changing the scope of the study, and using creative research strategies and controls possibly could have addressed some of the barriers identified by Price Waterhouse Coopers. Five years of technological progress among servicers, since the survey, may reduce the inefficiencies and difficulties in accessing some of the required data. Opportunistic use of a unique portfolio (see Hirad and Zorn below), while not industry wide, could have been one way to make incremental progress at meeting AHECI's charge.[25]

Nevertheless, the key barrier identified by Price Waterhouse Coopers remains the lack of consistent standard for collection of basic counseling information on a loan. Without such data, a broader and more nuanced understanding of the impact of counseling remain elusive. Originating and servicing mortgages is a data-intensive proposition, where the additional cost of adding even one data element becomes multiplied by hundreds of thousands, if not millions of loans. The research literature on counseling does not address what the cost would be to the mortgage industry to include such data collection as a standard part of their business.

Mallach (2001)

Alan Mallach provided a valuable service by analyzing the 11 empirical studies[26] identified by Strauss and Phillips (1997) from the last 30 years on homeownership counseling. He noted that 10 of the studies were funded or conducted in-house by the U.S. Department of Housing and Urban Development (HUD) and were conducted more than 20 years ago. Mallach's general summary of this body of research's findings is that:

> "Seen as a whole, the outcome of the studies…is highly ambiguous. Moreover, serious limitations with respect to the design and conduct of the studies severely compromise the value of such findings that can be derived from the research."[27]

[25] This author was directly involved in consideration of such a project in 2000 that did not proceed for unrelated reasons, so at least anecdotally, such opportunities exist.
[26] Mallach cautions that he used a "generous" definition of "empirical". Also, note that Mallach's paper was done before the release of the Hirad and Zorn study discussed below.
[27] Mallach 2001, p. 4

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Simply put, Mallach places no faith in any of the findings of these 11 studies due to flaws in how the research was done. Even more disappointing for the purpose of this review, Mallach goes on to say that the research findings for pre-purchase counseling are limited.

Mallach outlines serious challenges facing researchers wanting to study homeownership counseling (which apply to both pre- and post-purchase counseling). Lender data problems include various inadequacies of their databases (see previous discussion of McGilvray 2000) and the lack of an incentive to correct these shortcomings. While nonprofits are likely to have data, Mallach is concerned that the number of loans will be too small, non-counseled homebuyers will not be available for a control group, and nonprofits lack the ability to sufficiently track former clients for a long period.

Mallach points to more serious study design issues, which tainted all of the 11 studies.. For instance, the lack of a common definition and standards for what constitutes homeownership counseling can preclude comparison across, or even within groups, of counseled borrowers. Furthermore, the different components of counseling programs need to be unbundled, as "…we do not know how each element, either separately or in conjunction with the others, affects home buying and home owning behavior.[28]

Sound research design requires matching control and experimental groups. Mallach argues that this is critically difficult because there are a variety of other factors that affect homebuyers' behavior.[29] Identifying an issue that plagues other social science and medical research, and setting up a control group that does not receive the intervention being examined raises ethical issues. When mortgage default—a potentially devastating outcome—is hypothesized as more likely absent the intervention of counseling, one can rightly question the ethics of withholding "treatment". Finally, Mallach argues that a longer time frame than most studies have included is required to get at the true impact.

Mallach sees no overwhelming incentive for either the nonprofit or the lending community to devote significant resources to better understanding his research priorities, how and why counseling works. The interest in what works is there, according to Mallach citing that

---

[28] Ibid p. 11

[29] While still true, the progress that has been made in the predictive default models that lie behind automated underwriting and servicing systems could conceivably reduce some of the uncertainty about matching factors that change financial behavior.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

three of the four literature reviews he identified appeared since 1996.[30] He argues that this interest is traceable to the increased demand driven by the requirements of the Community Reinvestment Act and the GSE affordable housing goals. On a hopeful note, Mallach suggests that the ability to do a rudimentary typology, in his concluding section, suggests that the industry is becoming more comprehensive and standardized.

Ards and Myers (2001)

Sheila Ards and Samuel Myers lay down a challenge to the housing industry—counselors included—to understand their consumer, and not just assume that traditional counseling can open doors currently locked for blacks. Their article challenges the "myth of bad credit in the Black community" with the authors reporting that:

> "Blacks almost uniformly reject the contention that their poor economic outcomes are due solely to their credit deficiencies. They deny that they have brought on themselves poor credit records. At the same time, they privately admit that the perception of Blacks as poor credit risks is widely held both in the Black community and the community at large."[31]

Ards and Myers use the debate over the findings of the Boston Fed study[32] to highlight what they believe to be the dominant belief, among social scientists and economists, that discrimination does not play a significant role in lending decisions involving black borrowers. They argue that this view exemplifies the dominant perceptions quoted above about blacks having bad credit. The authors develop an alternative explanatory narrative about the impact of the historical legacy of discrimination in credit markets on the current attitudes held by blacks and leading to general perceptions about credit among blacks. Relying on a fascinating historical analysis of black and white credit use in the early 1900s, they demonstrate that, due to discrimination, blacks were forced to use less favorable credit mechanisms. Eventually, this led to a historical overrepresentation of blacks using installment credit–a credit line with less favorable terms. Ards and Myers argue that blacks had historically higher savings rates, paying cash for many purchases, not surprising in light of pervasive historical credit discrimination.

The authors make a compelling case that this narrative is the historical antecedent to findings such as those that emerged in the results from a 1999 Freddie Mac survey of consumer

---

[30] Quercia and Wachter 1996, Strauss and Phillips 1997, and McCarthy and Quercia 2000, all reviewed in this paper.
[31] Ards and Myers 2001, p. 224.
[32] Munnell, Browne, McEneaney, & Tootell 1996.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

attitudes towards credit. Some of the findings were controversial, playing into what the authors and others felt were false perceptions about racial differences in credit histories. However, Ards and Myers hone in on a key finding from the same survey showing that there was a far greater disconnect between persons with good credit and their perception of their own credit status among blacks than other racial or ethnic groups. In other words, many blacks with good credit disproportionately do not believe that they have good credit.

Ards and Myers suggest that this disconnect is rooted in the historical legacy of discrimination that has channeled blacks into credit channels, attitudes and behaviors that do not connect well with mainstream credit profiles. The authors report on a series of focus groups broken down, among other ways, by good versus bad credit and by race. The results of the focus groups highlighted a differential understanding of financial instruments and credit markets, and differing credit habits, which the authors argue is a product of a "legacy of barred opportunities to credit".

The implication of this analysis for homeownership counseling is that many feel that the solution to accessing quality mortgage credit is not as straightforward as simply teaching better finance and budgeting skills. Ards and Myers point to the phenomenon of predatory lending practices as evidence of the continuing perception of bad credit among blacks, creating a vicious cycle where people are lured into using the least favorable credit lines by virtue of their perceived bad credit, use of which continues to bolster the perception of bad credit.

Hirad and Zorn (2001)

In the first empirical study of demonstrating the impact of homeownership counseling in 20 years, Abdighani Hirad and Peter Zorn examined the performance of 40,000 mortgages originated under Freddie Mac's Affordable Gold[33] program. They sought answers to three questions:

[33] The Affordable Gold program is targeted (with limited exceptions) to borrowers earning 100 percent or less of area median income. Starting in 1993, Freddie Mac required Affordable Gold borrowers to be counseled, with loans submitted to Freddie required to document the counseling organization and the type of instruction given. Recognizing certain factors that lower risk, Freddie Mac exempts certain borrowers from this requirement, with that roughly three percent of Affordable Gold loans conveniently forming a quasi-control group for the study. Loans from the first quarter of 1993 through the fourth quarter of 1998 were included in the study. As an aside, Hirad and Zorn note that the Affordable Gold portfolio is clearly riskier than the average non-Affordable Gold loan in Freddie Mac's portfolio—90-day delinquency rates of 6.9 percent versus 1.8 percent, respectively—an important point in the debate over the financial benefit of homeowner counseling.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

- Could they empirically demonstrate that pre-purchase homeownership counseling significantly reduced 90-day delinquency rates?
- Are different approaches to homeownership counseling more or less effective at reducing 90-day delinquencies?
- Are there any differences in the effectiveness of different providers of homeownership counseling?

By virtue of their access to Freddie Mac data, Hirad and Zorn were able to append a rich set of data to the loans they examined. Data included underwriting variables as well as type of counseling and provider, scores from Loan Prospector used to predict probability of foreclosure, mortgage and property characteristics, borrower demographics, and variables controlling different economic environments experienced by borrowers. Given the bleak picture presented by McGilvray concerning the state of available data, Hirad and Zorn had a unique opportunity to conduct a powerful and robust study. Beyond the clearly unique data set, their work is clearly the most rigorous empirical research that addresses this question. The results are a benchmark in the literature on homeowner counseling.

While Hirad and Zorn's analysis offers many rich insights, they clearly demonstrate that counseling can reduce 90-day mortgage delinquencies by 19 percent, on average. With access to counseling approach, they were able to demonstrate how a borrower is counseled makes a difference. With appropriate controls, the study found individual programs to be the most effective at reducing delinquency rates (34 percent reduction), followed by classroom programs (26 percent), home study (21 percent) and telephone counseling (no impact).

Hirad and Zorn appropriately qualify their findings. Their key concerns are that the study was not a true experiment and was grounded in a time frame (1993-1998) after which the counseling industry matured and perhaps become more consistent in its approach. Importantly, their research questions the wisdom of requiring that all borrowers receive counseling. They suggest, as more appropriate, a nuanced sorting of borrowers into different approaches reflecting their relative risk.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Hartarska, Gonzalez-Vega, and Dobos (2002)

Hartarska and her colleagues present another empirical study suggesting homeownership counseling[34] reduces the incidence of default[35] on loans made to low-income borrowers. Borrowing a technique from the default literature, the authors' analyze controls for the age of defaulted loans, an important consideration for the duration of the counseling effect during the years of peak default risk.

Hartarska *et al* examine the Community Mortgage Loan Program, [36] developed in 1992 by PT & Associates, Huntington Bank and Fannie Mae. Borrowers were counseled and ultimately underwritten on a cash flow analysis of their living expenses and debt. Based on a borrowers ability to generate a net positive cash flow, this approach, better assesses repayment capacity of borrowers compared with what the authors call the "rigid income-to-debt ratios" [37] of the current system.

The results of the analysis suggest that counseled borrowers, in this program, experience default at one-half the rate of non-counseled borrowers. The borrowers speculate that this difference is a result of the counseling approach used producing a more accurate assessment of repayment capacity. The authors speculate that, if this is true, increasing low-income homeownership may be better served by investment in appropriate counseling rather than regulations and subsidies promoting low-income lending. Supply-side approaches, such as loosening credit standards and subsidizing loans, may just promote default because they are not correctly sizing repayment capacity of low-income borrowers.[38] If correct, the authors argue, counseled loans would attract lenders to the market, while regulation- and subsidy-driven lending would drive them away.

---

[34] In this study, the authors refer to what appears to be homeownership counseling as "credit counseling".
[35] This study uses a more restrictive definition of default, focusing on loans that (a) have been foreclosed, (b) result in a loss on loan for the lender, or (3) were terminated due to borrower delinquency.
[36] The Community Mortgage Loan Program requires all low-income potential borrowers to have some level of counseling, individually tailored to their current financial circumstances and behaviors. After their living expenses and debt are carefully verified, participants "graduate" when they are able to show a zero or positive cash flow for a given loan amount and interest rate. A five percent downpayment is required, although consumer financing is available if the borrower cannot afford this requirement.
[37] With the spread of automated underwriting systems and risk-based pricing, as well as the ascending importance of credit scores, it is unclear if this condition still holds true.
[38] It is unclear that such a simplistic bifurcation exists. For instance, while some may argue that regulatory regimes, such as the Community Reinvestment Act and the GSE affordable housing goals, force riskier lending, another perspective is that such regimes force collective experimentation. One assumes that the mortgage industry learns from this experience and incorporates these learnings into product design and underwriting criteria to better manage that risk in an ongoing, iterative process.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

The authors find that, while counseled borrowers arguably behave more prudently, financial sophistication also extends to the default decision. Their research suggests that counseled borrowers might default more than non-counseled borrowers when the option is financially attractive, considering their mortgage, equity in the house, and, possibly, other costs. Finally, Hartarska *et al* find a geographic variation in the impact of counseling, which they find more effective in inner city communities and less so in rural and suburban areas. They speculate that this may be due to special circumstances of the target population and a counseling provider that may have more or better information on their target population.

Getter (2002)

Darryl Getter revisits an old question about whether or not some borrowers are "credit-constrained" due to an inability to project their future income. An entire literature on credit rationing evolved in the context of credit markets that used to have binary outcomes in underwriting decisions (i.e., either you qualify or you do not.) Getter addressed the question in light of the rise of risk-based pricing, where the answer was not "yes/no", but rather "yes, for a price".

Getter uses the 1998 Survey of Consumer Finances to address a series of questions about whether or not the market works for mortgages, as well as consumer credit and auto loans. He finds that most rejected borrowers were delinquent and/or filed for bankruptcy in the year before being rejected. Getter also finds that riskier borrowers paid higher prices, and that creditworthy minorities did not pay unusually high prices for credit.[39] These findings suggest a well-functioning credit market.

However, Getter did find some troubling cases where some borrowers, of similar creditworthiness, paid higher rates than others with the same characteristics. After controlling for shopping behavior, Getter found that these cases could be explained by the fact that the borrowers paying the higher rates also reported that they did little shopping for a loan. This finding obviously suggests the value of homeownership counseling for individual borrowers who presumably learn how to shop for the most favorable loan terms.

[39] This analysis and conclusions is representative of the perspective to which Ards and Myers (2001), reviewed previously, object.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Todd (2002)

Richard M. Todd, vice president of the Federal Reserve Bank of Minneapolis, explored the intriguing notion that financial literacy education offers a potential tool for combating abusive lending practices, colloquially referred to as "predatory lending" (Todd 2002). Todd examines existing literature on three different approaches to financial training, including high school, workplace, and homebuyer training, suggesting that these approaches could combat predatory practices by empowering consumers with knowledge. While Todd's homebuyer training discussion reviews literature covered elsewhere in this paper[40], his assessment of key literature on high school and workplace financial literacy training is of interest.

Todd finds that existing research on high school financial literacy training suggests both short-term and long-term effects. The key short-term effects were an increased knowledge of credit behavior and increased savings among participants. However, these changes were unevenly distributed and concentrated in students who were less knowledgeable than their peers prior to completing the training, reflecting a "leveling up" of financial skills.

For these skills to be useful for combating predatory lending practices—Todd's focus—and by implication of value for educating borrowers, this training must have a more persistent effect. Todd examines a study examining the longer-term impact of high school financial literacy training, and finds evidence suggesting "…adults who attended state-mandated financial literacy training generally save more and accumulate more wealth than other adults". (Todd 2002)

Finally, Todd's review of workplace financial literacy training finds evidence of an individual impact from such training. For instance, one study found that "Well-designed programs of workplace financial training seem to change [savings] behavior..." Other studies, Todd reviewed, addressed knowledge gaps about the broader impact of workplace training finding that the impact of these programs extended more broadly, beyond just retirement program participation and contribution rates, promoting broader household savings patterns.

Fannie Mae (2003)

To understand what motivates consumers in the mortgage and financial arena, Fannie Mae conducted a nationally representative sample in 1999-2000 of 9,300 adults age 25 and over

[40] Quercia and Wachter (1996), McCarthy and Quercia (2000), and Hirad and Zorn (2002).

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

with household incomes over $30,000. African-American and English-dominant Hispanic households were over sampled and supplemented by a survey of about 1,800 Spanish-dominant and Bilingual Hispanic households in 2002. The survey consisted of 19 questions about personal characteristics, habits and attitudes, how consumers make tradeoffs, and experience with and knowledge about mortgage finance.[41]

While this is standard market segmentation work, this is a particularly under-researched topic in the housing community, with particular relevance to understanding how to develop mortgage products and approach underserved households.[42] The mortgage industry has typically viewed borrowers as first time buyers, repeat buyers, and refinanciers.[43] Fannie Mae's research discovered that there are more similarities than differences among these groups, and that segmenting borrowers into unique categories based on their needs, motivations, and fears yields a far richer and more relevant way to look at consumers, including how they approach shopping for a mortgage and a home.

From analysis of the survey results, six distinct market segments emerged. As marketing research typically does, these categories were based on a coherent cluster of attitudes and behaviors that constitute a reasonable profile of how an individual thinks about and shops for a product. The categories[44] that emerged were:

- Financially Challenged (1 percent)
- Affluent, Angry and Ignored (12 percent)
- Technophiles (15 percent)
- Friends and Family (15 percent)

[41] From the information available to this author, it cannot be determined if any questioned probed whether homeownership counseling provided the consumers with information. The summary discussion, however, does present statistics about where consumers got their information on mortgages, examining the role of who were trusted advisors and reporting responses on mortgage brokers, Realtors®, and family and friends.
[42] In fact, the industry's lack of information about what really makes customer "tick" was commented on by a participant at the 2000 Conference on Housing Opportunity held by the Research Institute for Housing America. While obviously decrying abusive lending practices, the participant observed that legitimate lenders and brokers could learn something on how to connect and sell to consumers from predatory actors, given their continued ability to lure customers into predatory loans. She was speaking to precisely this type of understanding and information that gets consumers to "yes", an understanding that can be used appropriately or abusively in practice.
[43] This author has long argued that Taco Bell knows more about why their customers buy their burritos than the housing world knows why consumers choose different mortgage products or how they shop.
[44] It is critically important to recognize that these terms are value neutral, and are not intended to judge individuals that fall into these categories. They are short descriptions intended to capture a particular set of attributes about how people think and act on the process of shopping for a mortgage. The terms do not define individuals, nor do they carry any value judgment. They do identify different styles of market engagement and preferences that are extremely useful in designing products and marketing that meets consumer preferences.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

- Technophobes (20 percent)
- Financially Confident (21 percent)

Within each of these descriptive categories, there is a rich profile of how a consumer thinks about shopping for a mortgage, how they find information that helps them make a decision, and how they make their decisions. This information is critical to developing appropriate products with features that meet their needs, as well as marketing strategies to connect consumers with opportunities.

It is beyond the scope of this paper to examine these categories and how they have helped single-family product development. Relevant to homeownership counseling is the fact that consumers are very different in how they shop and what they want. Traditional counseling does not assess potential clients in these terms. Such a screening could vastly change curricula and counseling for clients that fit the different consumer profiles. Understanding these profiles could help counselors identify what consumers really want and why, so that more appropriately tailored approaches could be designed that build on strengths and shore up weaknesses as counseled consumers shop for a mortgage.

Indiana Association of Community Economic Development (2003)

The Indiana Association of Community Economic Development (IACED) issued a plan in 2003 to improve the funding, governance, and pedagogic framework in which Hoosier nonprofit counselors operate. IACED called for launching a Homeownership Education and Counseling, or HomeEC, initiative, designed to ensure consistent quality and broadly accessible service across the state. Their report is an excellent example of a business plan developed and presented in the inclusionary and collaborative vernacular of nonprofits and their funders.

IACED benchmarked current practice[45] in homeownership counseling, particularly in state networks, and in curricula and course offerings. Then, through an extensive consultation process, they conducted what was essentially a field study in the political economy of the funding and organizational structure of the Indiana homeownership counseling industry. Their pulse taking of nonprofit and other key stakeholders yielded a sense of what would and would not work.

[45] The term "current practice" is distinct from "best practice", which usually implies a rigorous analysis to determine true causal impact.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Designed to motivate rather than mandate, the HomeEC initiative called for an incentive-based system of funding to promote regional collaboratives to increase geographic coverage of Indiana's counseling programs. Recognizing a potential bias towards more developed program players, HomeEC provided a safety net for areas "underserved" by counseling programs. The report recommended clearinghouses for tools and materials for Hispanics and special needs populations to help address their particular requirements for success.

IACED also recommended a "light touch" on certifying programs and credentialing counselors, preferring to recognize existing approaches they felt were solid. The report did define core elements of counseling and education as minimum thresholds, as well as minimum hours required, but left room for local variation. IACED laid out a monitoring structure to ensure that program offerings comply with core elements suggested by the report, and that counselors are current with their credentialing requirements.

These core elements and certification requirements represent the collective wisdom of experienced practitioners. These practitioners had to make educated judgments in the absence of research evaluating the true impact of homeownership. While solid research would certainly have helped inform their deliberations, even practices judged effective would have to be assessed against what was politically feasible, given the reliance on mostly existing players to get the job done.

Going forward, IACED's evaluation plan would not grapple with the knowledge deficit on the true impact of counseling. The report cites a number of concerns with more standard and rigorous evaluation methodologies often used to rigorously assess program impact. Instead, the proposed evaluation plan relied on process evaluation and output data to get a sense of whether or not their twin goals of consistency and accessibility were achieved.

Elliehausen, Lundquist, and Staten (2003)

Elliehausen *et al* provide a window into the world of credit counseling agencies with one of the few papers reporting on new research reviewed in this document. Counseling agencies provide financially troubled debtors with counseling on a specific set of skills and knowledge to

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

improve their financial health, and often to avoid bankruptcy.[46] The industry relies heavily on revenue from creditors being repaid by counseled consumers under structured plans.[47] Creditors have been reducing these fees, in recent years, which historically cross-subsidized individuals not participating in DMP's that form the majority of the client base of credit counseling agencies. This study was of particular interest to the credit counseling community as a rigorous way of demonstrating real impact to their business partners.

The authors examine the impact of credit counseling on recipients' overall risk profile, changes in debt levels and credit account usage, and payment behavior. [48] In addition to testing the overall impact of counseled, the authors specifically hypothesized that counseling would benefit those with lower Empirca scores more than individuals with better risk profiles. The study drew its experimental sample from clients of five credit counseling agencies affiliated with the National Foundation for Credit Counseling[49] (NFCC), who were counseled over the April-August 1997 timeframe. Counseling was one on one, although it was a mix of in-person and telephone contact. A comparison group not receiving counseling from the NFCC affiliates was selected from a pool of individuals in the same geographic locations and with similar Empirca scores. The final sample consists of about 11,500 individuals, roughly evenly split between counseled and non-counseled individuals. The study compared these groups with suitably blinded credit scores and credit file data from Trans Union at two points in time—June 1997, around which time counseling was provided, and June 2000, three years later.

In a rigorous but accessible discussion of their findings, Elliehausen *et al* find that credit counseling improves the performance of counseled individuals across the spectrum of measures they examined. The control group outperformed the comparison group, improving their overall risk profile as well as reducing debt levels, number of accounts, and delinquencies. While the

[46] Credit counseling is more comparable to post-purchase delinquency counseling as it is a crisis-driven intervention. Credit counseling also tends to have a narrower focus than homeownership counseling, which typically will teach credit management along with the other skills necessary to qualify for a loan and own a home.
[47] Debt Management Plans, or DMP's.
[48] While the housing world is familiar with FICO's, credit scores developed by Fair Isaac to evaluate consumer credit risk, this study uses a comparable credit score developed by Trans Union LLC called an Empirca score as a good measure of an individual's risk profile. Levels overall and non-mortgage debt were examined. The number of non-zero balance accounts held by an individual measured account usage. Finally, the authors used the number of annual 30+ day delinquencies to assess payment behavior.
[49] The NFCC's web site (www.nfcc.org) states that the organization, "…through its Member agencies, sets the national standard for quality credit counseling, debt reduction services and education for financial wellness".

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Empirca score is a composite measure, the authors argue that better performance on the specific measures require changed behavior induced by credit counseling.

More significantly, the study finds an interesting bifurcation when percentile ranges of Empirca scores are used to contrast the three-year changed in the control and comparison groups. The authors' initial hypothesis that higher risk individuals would benefit more from credit counseling was borne out across all the measures tested in the analysis. While counseled borrowers that started in the 10th percentile of the Empirca scores had a 36 percent better improvement in their risk profile than did non-counseled borrowers, counseled borrowers in the 90th percentile did almost 50 percent worse than their non-counseled counterparts. This pattern of higher relative improvement for the low-scoring counseled individuals was repeated in all the specific measures tested.

The authors speculate that this phenomenon may flow from a number of factors. Individuals with higher initial credit scores may be seeking out counseling in anticipation of a pending crisis, something that would yet show up in credit scores. Thus, the impact on their credit scores may lag their initial entry into counseling. In addition, these individual's higher initial scores suggest that the financial magnitude of their crises may be larger. They simply have farther to fall, and their holes may be deeper in absolute terms. Finally, the authors suggest anecdotal evidence that many of the initially higher scoring individuals that "fall" are in business and are trying to protect assets. In this light, degraded relative performance on many of the specific measures—more credit accounts with balances due and more debt, for instance—may be a strategic response to preserve ownership of the assets of their business.

Wiranowski (2003)

Mark Wiranowski examines how education and counseling help sustain homeownership for underserved borrowers. Wiranowski focuses on post-purchase counseling, distinguishing between approaches emphasizing prevention, which he terms "homeownership sustainability training" and crisis intervention, coined "delinquency counseling" in the study. His research uses extensive interviews with key stakeholders in both the pre- and post-purchase world to outline the current operational contours of counseling industry practice, funding, and organization.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Wiranowski insightfully develops the asymmetry between practitioners and the mortgage industry in post-purchase versus pre-purchase counseling. He attributes the closer (although far from perfect) integration between business and nonprofits on the pre-purchase counseling side to the public policy imperative of increasing homeownership. Post-purchase counseling suffers from an inability to attract consumers (for general education) and a more disconnected, sometimes adversarial relationship between servicers and nonprofits (for delinquency prevention). In particular, Wiranowski notes the increased sophistication of industry loss-mitigation technology and procedures[50] are defining and dominating the playing field for nonprofit delinquency counselors. Here is a case where the consumer and lending industry interests converge,[51] and nonprofits have not yet found the right niche in this relationship. Wiranowski finds that, while nonprofits should find common cause with industry actors most concerned with loss mitigation (e.g., servicers and insurers), community groups have not yet established the same level of connectivity with these actors as they have with lenders on the pre-purchase side.[52] He also argues that this asymmetry means that the mortgage industry will need even more convincing research that post-purchase counseling, typically more costly and intensive, is worth the investment.

Wiranowski recommends a range of business models be developed and tested that integrate pre- and post-purchase counseling and education. He argues that nonprofits need to develop their capacity to operate in a more efficiently and effectively, so that they can provide these services in response to lending partners' business requirements, not as a cause worthy of a charitable contribution. He also recommends reorienting public funding and policy towards supporting an increased post-purchase counseling emphasis.

---

[50] See Cutts and Green (2004) for an excellent overview and analysis of the past decade of technological innovations in servicing policies and tools for resolving problem loans. The authors find these innovations have been effective at reducing costs and keeping delinquent borrowers in their homes. Using these innovations, the authors find that the risk of home loss has been decreased by 80 percent for all loans, while low- and moderate income borrowers who enter a repayment plan reduce their risk of losing their home by 68 percent. In addition, the authors provide an excellent taxonomy of the stages of delinquency and workout options.

[51] See Capone (1996) for an early identification of the cost savings to servicers as a major driver of industry efforts to work with consumers to keep them in their homes.

[52] Part of the asymmetry comes from the fact that the origination staff typically drives the business in financial institutions, dominating servicing interests. Also, fee income servicers that do not own loan residuals have less at stake than those servicers owning the servicing asset, where the cost is loss of fee income and impaired assets. However, some promising signs have emerged from efforts to address the workout of predatory loans. For instance, see the Chicago initiative described at www.nw.org/network/aboutUs/nwNetwork/networkInTheNews/current/netNews092303.htm.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Reed (2003)

The firm of Reed Haldy McIntosh conducted a series of focus groups for the Mortgage Bankers Association to improve understanding of the mortgage application process in the African-American and Hispanic/Latino communities. Reed held four focus group meetings in January 2003 with two African-American and two Hispanic/Latino groups, each broken down further into those with household incomes over $50,000 and those under $50,000. All participants had recent experience with applying for mortgages for their homes within the past year or during the time when the focus groups were conducted. The majority had or was having their first experience financing their home. Expert moderators, with market research experience in African-American and Hispanic communities, led the sessions.

The sessions produced five key highlights. Most found that the application process worked reasonably well. Most participants found a network of trusted and knowledgeable individuals to be critical for navigating the application process. While participants understood the need for lenders to protect their interest in the loans, they did not understand how the barrage of paperwork and information requested was linked to that goal. In fact, many found the process to be intrusive. Although unable to cite specific personal experiences, most felt African-Americans were discriminated against in the homebuying process. Special focus was placed on real estate agents and perceived unequal treatment, particularly in the homes made available to them. Finally, only the Hispanic/Latino group with incomes below $50,000 expressed concern about predatory lending practices. Participants in this group had the least access to trusted sources of information, were the least knowledgeable about the mortgage application process, and were more likely to rely on real estate agents to find mortgage lenders.

Carswell (2004)

Andrew Carswell expands the frame of understanding counseling's impact beyond loan performance to include additional outcome measures reflecting the satisfaction of the counseled borrowers with their dwelling and neighborhood. Measuring the broader output of counseling should take into account the many facets of the product of homeownership. Loan performance benchmarks counseling's success in improving financial outcomes for borrowers and lenders. But homes are more than a financial investment, benefiting homeowners with a stream of

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

housing services—the physical dwelling—and the package of benefits (i.e., good schools, access to transportation and jobs, etc.) associated with their neighborhood.

Carswell gets at these three benefits by measuring the satisfaction of borrowers, who had been through counseling from nonprofits, in Philadelphia. A 40-question survey was sent to a set of previously counseled borrowers in 1997, five years after they first moved into their homes. The questionnaire used a 5-point Likert scale and asked 14 questions on dwelling unit satisfaction, 20 questions on neighborhood satisfaction, and six questions on financial performance. Of 1,700 borrowers mailed a survey, 405 (24 percent) responded. In addition, information was procured on borrower demographics and neighborhood characteristics from Census data and the city's Office of Housing and Community Development. Finally, counseling agency data on programs and policies was gathered from interviews, as well as HUD, the IRS, and the Urban Institute.

Interestingly, Carswell found weak agency effects on neighborhood and dwelling unit satisfaction among these counseled borrowers, leading him to speculate that counselors' placed a low priority on these measures in their counseling efforts. He also found troubling variations in some agencies' emphasis on the importance of paying one's mortgage as the top priority in the billing cycle. Another key finding was a linkage between agencies with opening educational sessions and lower levels of dwelling unit satisfaction, which the author speculates may reflect less one-on-one counseling on dwelling unit characteristics.

Carswell make a significant contribution by framing the impact of counseling in a broader context, reflecting other characteristics of homeownership beyond just the financing and budgeting. The study's findings of weak effects of counseling on dwelling unit and neighborhood satisfaction would seem to belie nonprofit's beliefs that counseling is about more than just a loan. But the counseling did occur over a decade ago, just as the national emphasis on homeownership was ramping up demand for counseling. A decade of experience would certainly offer room for improvement on those measures.

Hornburg (2004)

Steven Hornburg presented research on the extent and practice of nonprofit mortgage brokers. Key informant interviews of ten individuals, predominantly nonprofit practitioners and

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

leaders of national intermediaries and lending partners, and three case studies supplemented a national survey of the practices of these organizations.

General recommendations emerging from this research centered on developing business models that homeownership counseling agencies could develop to secure more sustainable revenues. In particular, one recommended model focused on the potential for existing counseling agencies to rationalize their business processes to better partner with their local lending partners on a fee-for service basis.

In discussing the challenges and opportunities, Hornburg reported that the survey findings and key informant interviews painted a picture of a nonprofit homeownership counseling industry somewhat disconnected with mainstream market practices. In particular, key informants suggested that most counselors are unfamiliar with current business practices (particularly the current risk-based underwriting approach for products in the prime market), typically only have an understanding of a few affordable loan products, and do not use the automated underwriting technology that currently drives the origination process.

These findings complement the consumer behavior knowledge gap discussed elsewhere in this paper. This lack of connection to market practice and products suggests that more information is needed on how to elevate counselor training and practice, as such information is key to helping consumers of counseling services access appropriate mortgage products.

Considerations Going Forward

Most practitioners would argue they know the impact of counseling, and do not need research to prove anything. Furthermore, many express an aversion to formal research due to the burden data collection imposes on an already stretched staff and ethical concerns about using control groups, a necessary part of any serious, credible research effort.[53] And the bottom line is they see their success in the community where they live.

Unfortunately, personal testimony, anecdotes, and process indicators only go so far in leveraging support from funders. Increasingly, funders want some assurance of real and demonstrable impact. Despite the belief, held by some, that the improved loan performance of counseled borrowers should be paid for by the mortgage industry, the counseling community has

[53] See Quercia and Wachter 1996.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

simply not built the case to demonstrate that value with any predictable consistency.[54] Furthermore, with overwhelming demand and chronic under funding, practitioners should welcome any knowledge that lets them do their jobs more efficiently and effectively.

With this perspective in mind, the following summary of key learnings and priority research issues is presented.

What We Know: A Little Bit of Knowledge

- We know less than we think we do. - Most of the papers reviewed indicate we do not know what approaches work best and for whom.
- While the research tools are available, data tracking and collection that would aid impact evaluation is very spotty to non-existent. – Data collection by nonprofits is a very spotty proposition. McGilvray (2000) clearly indicated the mortgage industry essentially ignores any tracking of homeownership counseling. Mallach (2001) notes the undependability of data collected by nonprofits. Data such as what Hirad and Zorn (2001) had access to are worth their weight in gold.
- Pre-purchase counseling can be effective at improving loan performance. - Only two studies—Hirad and Zorn (2001) and Hartarska et al—present credible and rigorous finding of impact on loan performance. These impacts (19 and 50 percent reductions in delinquencies, respectively) are suggestive of the power of counseling to change behavior and outcomes.
- Credit counseling can be effective in changing behavior and improving the financial characteristics of individuals. – Elliehausen et al offer powerful evidence that credit counseling can improve credit scores and improve financial behavior.
- The nonprofit counseling industry is at risk of being marginalized by a lack of connection to mainstream market developments. – At the risk of being the Cassandra of the counseling world, the lack of more solid and systemic knowledge about counseling's impact may keep nonprofits underfunded. Demonstrating what kind of counseling works for whom and under what circumstances could convert funding for counseling from charity to a value proposition that should be appropriately compensated. Furthermore, if

[54] Lenders and investors can also legitimately argue that these loans are still riskier than their mainstream business. See Hirad and Zorn (2001) and Van Order and Zorn (2002) for the risk of affordable loans compared to other prime loans.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

counselors continue to view subprime lending as a workout issue and are not grounded in current market technology and products, their relevance to market choices and options facing borrowers becomes diminished. Finally, the mortgage industry's development of a robust and mostly favorable relationship with consumers in loss mitigation makes it harder for nonprofit counselors to establish relevance in the process.

- Consumer attitudes and knowledge of the market, and how they affect behavior and success, are still poorly understood, although preliminary research suggests a powerful influence. – Emerging research about how consumers view and engage the market (Ards and Myers 2001, Fannie Mae 2002, and Reed 2003) holds critically important insights that can help improve homeownership counseling by making it more relevant and useful for consumers. Empirical evidence (Getter 2002) suggests the benefits of being a knowledgeable consumer who knows how to shop.

What We Need to Know: A Lot Left to Do

- We must increase our knowledge of what works, what does not, who benefits, and who should pay for homeownership counseling, using credible research techniques.
- We must clearly articulate goals that broaden success measures and provide testable propositions, but also needs to recognize that loan performance is still the key metric that demonstrates value to current primary funders and business partners.
- We must move beyond traditional modes of research and data to embrace the contributions other approaches such as behavioral economics[55] and opinion research can make to understanding the impact of counseling.
- We must address a major information gap on how consumers think about the market and behave in shopping for mortgages and looking for homes.
- We must address the apparent gap between counseling practice and market technology, products, and practice.
- We must advocate for integrating data collection on homeownership counseling within the framework of broader research efforts like the Survey of Consumer Finance or Fannie Mae's Consumer Segmentation research.

---

[55] See Hilgert and Hogarth 2003 for an example of how behavioral economics can be used to assess the impact of financial education.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

References

Ards, Sheila D. and Samuel L. Myers, Jr. 2001. The Color of Money: Bad Credit, Wealth, and Race. *American Behavioral Scientist* Vol. 45 No. 2: 223-239.

Baker, Christi, based on the work of Gorham, Lucy S., Roberto Q. Quercia, and William H. Rohe. Forthcoming in August 2004. Three Reports on Post-Purchase Programs. Fannie Mae Foundation. Washington, DC.

Braunstein, Sandra and Carolyn Welch. 2001. Financial Literacy: An Overview of Practice, Research, and Policy. *Federal Reserve Bulletin* November 2002. Federal Reserve. (http://www.federalreserve.gov/pubs/bulletin/2002/1102lead.pdf)

Brown, Thalia. 2002. Homeownership Counseling: Effectiveness, Trends, and Research. Consultant Report presented to the Millennial Housing Commission, Washington, DC. (http://www.mhc.gov/reports/brown.doc)

Capone, Charles. 1996. *Alternatives to Mortgage Foreclosure: A Report to Congress.* U.S. Department of Housing and Urban Development. Washington, DC. (http://www.huduser.org/Publications/pdf/alt.pdf)

Capone, Charles. 2002. *Research Into Mortgage Default and Affordable Housing: A Primer*. Presented at the LISC Home Ownership Summit 2001, November 8, Washington, DC.

Carswell, Andrew T. 2004. Determining Homeownership Agency Effectiveness Outcomes in the City of Philadelphia. Paper presented at the American Real Estate and Urban Economics Association Mid-Year Meeting, June 1-2, Washington, DC.

Carr, James H. and Jenny Schuetz. 2001. Financial Services in Distressed Communities: Framing the Issue, Finding Solutions. Report. Fannie Mae Foundation. (http://www.fanniemaefoundation.org/programs/financial.PDF)

Carliner, Michael. 1998. Development of Federal Homeownership "Policy". *Housing Policy Debate* Volume 9, Issue 2: 299-321.

Cutts, Amy Crews and Richard K. Green. 2004. Innovative Servicing Technology: Smart Enough to Keep People in Their Houses? Working Paper #04-03. Freddie Mac.

Elliehausen, Gregory, E. Christopher Lundquist, and Michael E. Staten. The Impact of Credit Counseling on Subsequent Borrower Credit Usage and Payment Behavior. Paper provided to the Finance & Consumption Conference - The Economics of Consumer Credit: European Experience and Lessons from the US. May 13-14, April 2003, Florence, Italy. (http://www.iue.it/FinConsEU/ResearchActivities/EconomicsOfConsumerCreditMay2003/Papers/Staten.pdf)

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Fannie Mae. 2003. *Executive Summary – Fannie Mae Consumer Segmentation Study.* Washington, DC. (http://www.sabor.com/comits/eoh/FNM-Consumer-Study.doc)

Getter, Darryl E. 2002. Are Rejected Households Credit-Constrained or Simply Less Creditworthy? Working Paper HF-016. Department of Housing and Urban Development. (http://www.huduser.org/Publications/pdf/workpapr16.pdf)

Gwatkin, Kathryn and George McCarthy. 2003. Whither Homeownership Education and Counseling? *Rural Voices* Spring 2003: pp. 2-6.

Hartarska, Valentina, Claudio Gonzalez-Vega, and David Dobos. 2002. Credit Counseling and the Incidence of Default on Housing Loans by Low-Income Households. Unpublished manuscript.

Hilgert, Marianne A. and Jeanne M. Hogarth. 2003. Household Financial Management: The Connection between Knowledge and Behavior. *Federal Reserve Bulletin* July 2003: pp. 309-322.

Hirad, Abdighani and Peter M. Zorn. 2001. A Little Knowledge is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling. Report. Freddie Mac. (http://www.freddiemac.com/corporate/reports/pdf/homebuyers_study.pdf)

Housing Assistance Council. 1994. Housing Counseling in Rural America. Mimeo. Washington, DC.

Hornburg, Steven. 2004. Nonprofit Mortgage Brokers: Small Step or Large Leap? Forthcoming Report. LISC. (Draft available from author)

Indiana Association for Community Economic Development. 2003. *Report and Recommendations on the Status of Indiana's Homeownership Education & Counseling System.* Indianapolis, IN. (http://www.iaced.org/HomeECFinalReport.pdf)

Mallach, Allan. 2001. Home Ownership Education and Counseling: Issues in Research and Definition. Discussion Paper. Federal Reserve Bank of Philadelphia. (http://www.phil.frb.org/cca/capubs/homeowner.pdf)

McCarthy, George W. and Roberto G. Quercia. 2000. Bridging the Gap between Supply and Demand: The Evolution of the Homeowner Education and Counseling Industry. Institute Report No. 00-01. Research Institute for Housing America. Washington, DC. (http://www.housingamerica.org/docs/RIHA00-01.pdf)

McGilvray, Margaret. 2000. AHECI – Homeowner Education and Counseling Cost and Benefits Study Data Availability Survey Report. PowerPoint presentation at the Research Institute for Housing America's 2000 Conference on Housing Opportunity ("Homeowner Education and Counseling:

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Creating an Industry to Expand Housing Opportunity"), April 6, Washington, DC. (http://www.housingamerica.org/downloads/MMcGilvray.ppt)

Munnell, A.H., L.E. Browne, J. McEneaney, & G.M.B. Tootell. 1996. Mortgage Lending in Boston: Interpreting HMDA Data. *American Economic Review* 86(1), 25-54.

Quercia, Roberto and Susan Wachter. 1996. Homeownership Counseling Performance: How Can It Be Measured? *Housing Policy Debate* Volume 7, Issue 1: 175-200.

Reed, Theodore. 2003. Insights into the Minority Homebuying Experience: The Mortgage Application Process. Report. Research Institute for Housing America. (http://www.housingamerica.org/docs/3744_InsightsMinority.pdf)

Rohe, William M., Shannon Van Zandt and George McCarthy. 2001. "The Social Benefits and Costs of Homeownership: A Critical Assessment of the Research." In Nicolas P. Retsinas and Eric S. Belsky, Eds. *Low-Income Homeownership: Examining the Unexamined Goal.* Brookings Institution Press and Harvard University Joint Center for Housing Studies (http://www.jchs.harvard.edu/publications/homeownership/liho01-10.pdf)

Ross, Stephen L. and John Yinger. 2002. *The Color of Credit: Mortgage Discrimination, Research Methodology, and Fair-Lending Enforcement.* Cambridge, MA: The MIT Press.

Shabecoff, Alice. 1994. Home Owner Education: An Informal Review of the Industry. Mimeo. Washington, DC: Fannie Mae Foundation.

Schoenholtz, Andrew and Kristin Stanton. 2001. Reaching the Immigration Market: Creating Homeownership Opportunities for New Americans". Report. Fannie Mae Foundation and Georgetown University.
(http://www.fanniemaefoundation.org/programs/pdf/rep_immigrant.pdf)

Strauss, Leslie and Sue Phillips. 1997. Housing Counseling in Rural America. Report. Housing Assistance Council. (http://www.ruralhome.org/pubs/counseling/tableofcon.htm)

Todd, Richard M. 2002. Financial Literacy Education: A Potential Tool for Reducing Predatory Lending? *The Region* December 2002. Federal Reserve Bank of Minneapolis. (http://minneapolisfed.org/pubs/region/02-12/literacy.cfm)

U.S. Department of Housing and Urban Development. 2004. *CFO Reports Congressional Justifications for 2005 Estimates.* Washington, DC. (http://www.hud.gov/about/budget/fy05/cjs/part2/housing/hsgcounassist.pdf)

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

U.S. Office of Management and Budget. 2004. *Historical Tables: Budget of the U.S. Government, Fiscal Year 2005.* Washington, DC. (http://www.whitehouse.gov/omb/budget/fy2005/db.html)

Van Order, Robert and Peter Zorn. 2002. "Performance of Low-Income and Minority Mortgages." In Nicolas P. Retsinas and Eric S. Belsky, Eds. *Low-Income Homeownership: Examining the Unexamined Goal.* Brookings Institution Press and Harvard University Joint Center for Housing Studies (http://www.jchs.harvard.edu/publications/homeownership/liho01-10.pdf)

Vitt, Lois A., Carol Anderson, Jamie Kent, Deanna M. Lyter, Jurg K. Siegenthaler, and Jeremy Ward. 2000. Personal Finance and the Rush to Competence: Financial Literacy Education in the United States. Report. Fannie Mae Foundation. (http://www.fanniemaefoundation.org/programs/pdf/rep_finliteracy.pdf)

Wiranowski, Mark. 2003. Sustaining Home Ownership Through Education and Counseling. Working Paper W03-7. Joint Center for Housing Studies of Harvard University. Cambridge, MA.

© 2004 President and Fellows of Harvard College. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.