

PUBLIC COMMENT

HAWK for New Homebuyers

Comment to the U.S. Department of Housing
and Urban Development on a proposed
four-year, two-phase housing counseling pilot

July 14, 2014



The UNC Center for Community Capital at the University of North Carolina at Chapel Hill is the leading center for research and policy analysis on the transformative power of capital on households and communities in the United States.

The center's in-depth analyses help policymakers, advocates and the private sector find sustainable ways to expand economic opportunity to more people, more effectively.

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July 14, 2014

Ms. Helen R. Kanovsky, General Counsel
Attention: Comments/FR-5786-N-01
Department of Housing and Urban Development
451 7th Street SW, Room 10276
Washington, DC 20410

RE: The Department of Housing and Urban Development's proposed four-year, two-phase, housing counseling pilot, "HAWK for New Homebuyers"

Dear Ms. Kanovsky:

Thank you for the opportunity to comment on the HAWK for New Homebuyers pilot. The Center for Community Capital at the University of North Carolina at Chapel Hill conducts research and policy analysis on ways to improve financial services for all people, and much of our work is committed to furthering the policies and regulations necessary for a vibrant and sustainable mortgage market. The Center's long-term panel study of homeowners, the Community Advantage Panel Survey (CAPS)¹, adds to this expertise on issues related to affordable homeownership; a recent book, *Regaining the Dream*, aggregates over a decade of this research and provides ample evidence that broad access to mortgage credit can be provided profitably and in accordance with sound practices.

¹ The Community Advantage Program (CAP) is a secondary market program developed through a partnership between the Ford Foundation, Fannie Mae and Self-Help, a community development finance institution in Durham, NC. CAPS includes rich data on nearly 50,000 low- and moderate-income and minority homeowners and has enabled the Center for Community Capital to identify specific lending practices and policies that enable or inhibit successful homeownership. For additional information on this research, visit the Center's website: <http://ccc.unc.edu/projects/community-advantage-panel-study-2/>

One such sound practice is effective homeownership counseling; as pointed out by the Center's research, homeownership counseling programs have the potential to offer direct benefits to participants and should be a central component of federal homeownership policy (Quercia and Spader 2008). Throughout history the FHA has served the important role of testing and standardizing loan products later adopted by the private sector (Quercia and Park 2013); the HAWK pilot has the potential to continue this important work by setting the standard for housing counseling and education throughout the home buying process.

The HAWK pilot also represents the opportunity to provide empirical evidence regarding the effectiveness of homeownership counseling, an element that has long been missing from discussions regarding the value of counseling requirements. The Pre-Purchase Homeownership Counseling Demonstration and Impact Evaluation is an important first step toward this goal; the Center for Community Capital is pleased to participate in this research effort, as its careful experimental design and emphasis on sound protocols offer the potential to effectively document the benefits of housing counseling on a range of outcomes.

We applaud the HAWK pilot's stated goals of improving the performance of the FHA's mortgage fund, expanding the number of families who benefit from homeownership counseling and increasing access to sustainable home mortgages for buyers underserved by the current market. The following recommendations are offered with the intent of strengthening the pilot's ability to achieve these important objectives and are detailed throughout the remainder of this letter:

- 1. Encourage a variety of delivery methods for counseling services, while ensuring and monitoring the quality of the curriculum as well as the capacity of the provider. Consistency in the quality of counseling is critical to the success of the program.**
- 2. Ensure that costs, benefits and incentives are structured in a manner that appeals to consumers, minimizes FHA losses and engages lenders.**
- 3. Leverage the pilot in order to strengthen networks and platforms for delivering high quality services.**
- 4. Build in careful evaluation of outcomes.**

1. Encourage a variety of delivery methods for counseling services, while ensuring and monitoring the quality of the curriculum as well as the capacity of the provider. Consistency in the quality of counseling is critical to the success of the program.

Today's homeownership counseling industry is diverse, and it is important to acknowledge that counseling can occur in formats ranging from classroom instruction to online courses. While the HAWK pilot should reflect this diversity in delivery methods, both the content and provider of homeownership counseling are critical to its effectiveness and should therefore be subject to more specific requirements. We recommend that the HAWK pilot encourage all types of delivery methods while setting clear standards for both counseling curricula and providers.

The specific format of the HAWK pilot, which proposes housing counseling and education occur at three distinct phases in the home buying process, is commendable for its focus on providing comprehensive counseling services. The pilot also clearly acknowledges the importance of pre-contract counseling, with the majority of hours required before a home purchase contract is signed. Findings suggest that both the timing and intensity of homeownership counseling are important determinants of its effectiveness, and that instruction administered by a neutral third party to the mortgage transaction has the potential to offer the most unbiased, comprehensive service (Quercia and Spader 2008).

We support the comprehensive counseling requirements outlined by the HAWK pilot and recommend that homeownership counseling services occur through third party, independent counseling providers who meet certain performance standards. Providing clearer criteria regarding counseling content and providers is an important step in fulfilling the pilot's potential to set industry wide standards for homeownership counseling. We urge HUD to do this in a manner that ensures quality content and effective service are provided over a range of delivery methods; this requires building in monitoring of the quality of counseling delivered.

2. Ensure that costs, benefits and incentives are structured in a manner that appeals to consumers, reduces FHA losses and engages lenders.

It is imperative that funding for the HAWK pilot is carefully structured. If funding levels are insufficient, both the quality of counseling and its outcomes will suffer; as stated previously, the benefit of homeownership counseling is tied to its quality. Counseling services have been estimated to cost \$500 to \$1,500 per consumer, depending on the level of activities offered². The pilot's projection that \$500 will cover reasonable and customary fees is at the low end of this range and may not accurately represent the true

² NeighborWorks America (2005). "Measuring the Delivery Costs of Prepurchase Homeownership Education and Counseling."

<http://www.nw.org/network/pubs/studies/documents/MeasuringtheDeliveryCostsofHBE.pdf>

cost of providing the comprehensive, high quality counseling envisioned and required to generate the performance benefits projected. It would be a shame if counseling of widely varied quality resulted in inconclusive findings about the value of the program. Therefore we recommend that HUD insist on quality counseling and make the commitment to structuring costs, benefits and incentives in a manner necessary to achieve this goal.

It is important to carefully consider the program's appeal to consumers, taking into account the psychological factors that often affect financial decisions, such as status-quo bias, present bias and loss aversion³. The estimated \$300 fee for pre-contract counseling is a not only a significant upfront cost for many consumers but also represents an element of risk; after undergoing the first phase of counseling a consumer may ultimately decide not to apply for a FHA mortgage or even purchase a home. While consumers may be willing to pay a nominal fee for counseling services, high upfront cost coupled with benefits that may not materialize in the future could serve to discourage many from participating in the pilot; both present bias and loss aversion are significant factors.

To increase participation, the broader benefits of housing counseling and education should be cited in the marketing and promotion of the program. As a quantifiable incentive, the proposed basis point reductions to FHA mortgage insurance premiums are an appropriate starting point; however, the full benefit of effective homeownership counseling goes far beyond savings on mortgage payments. We recommend that both the marketing and study of the HAWK pilot emphasize wider outcomes such as improved financial management, better credit scores and more sound decisions (for example, choosing a home and mortgage that can be sustained).

While it is important to communicate the full range of benefits to participants, it is also important to acknowledge that there are real limitations to consumer investment in homeownership counseling. This suggests that incentives should be carefully considered and that other parties, such as HUD and lenders, may be better positioned to underwrite the program's cost. We strongly endorse the prospect of lenders paying for counseling services, as they are clear beneficiaries of stronger borrowers. However, incentives and motivations may not be strong enough for lenders to push the program, and relying on lenders alone to fund and publicize the program may not be sufficient or realistic.

Therefore, we encourage the consideration of alternative financial structures and sources of funding in order to offset the true cost of providing high quality

³ Status-quo bias is psychological resistance to change while present bias is the tendency to place a higher value on immediate rewards. Loss aversion references the observation that most people are more sensitive to losses than gains. Shlomo Benatzi (2012). "Behavioral Finance 2.0." *Project M* pp. 6-14.

homeownership counseling services and to effectively engage all stakeholders. The potential mortgage payment savings over a five-year period represents a significant amount of money on the table⁴, and we recommend HUD consider testing a few different models for funding counseling services. For example, some or all of the projected mortgage insurance premium savings could be capitalized in an up-front lump sum, divided between offsetting counseling costs and providing an immediate incentive to borrowers. Alternatively, the post-purchase/good payment performance premium reduction could be split between lenders and counseling agencies in some manner, serving to align stakeholders' goals with those of FHA. These suggestions are just examples of ideas that could be explored to more effectively structure the benefits in order to increase uptake and participation.

3. Leverage the pilot in order to strengthen networks and platforms for delivering high quality services.

It is important to acknowledge that homeownership counseling is just one of the services needed in an equitable, sustainable mortgage market. The HAWK pilot's commitment to homeownership counseling is a strong first step toward improving outcomes for homeowners; however, the need for increased financial literacy is just one of the challenges facing many consumers. A recent roundtable discussion hosted by the Center for Community Capital focused on the need for viable low-down payment lending⁵, and *Regaining the Dream* points out that sensible underwriting and servicing, where lenders proactively work with distressed borrowers to keep them in their homes, are key elements of successful lending to low-income families. Therefore, we recommend that the HAWK pilot be leveraged as one component of a more holistic network.

As stated previously, a well-funded program has the potential for the best outcomes, and a pilot that invests not only in counseling services but also in stronger, more integrated platforms has the potential to generate the most robust results. The HAWK pilot represents an important opportunity to strengthen linkages between counselors, lenders, servicers and the FHA. While the existing HOPE LoanPort is a step toward a clearinghouse of information, it could be enhanced to further integrate linkages; for example, counseling services provided through HAWK could be matched with other services shown to further reduce risk, such as down payment assistance.

The information exchange facilitated by such a clearinghouse has the potential to greatly enhance the delivery of a range of important services, and enhanced linkages

⁴ A buyer with the average FHA loan balance of \$180,000 is estimated to save approximately \$325 a year, for a total of \$1625 over a five-year period and almost \$9,800 in savings over the life of the loan.

⁵ Developing the Blueprint for Viable Low-Down-Payment Lending: Highlights and Common Themes. An invitation-only roundtable discussion hosted by the UNC Center for Community Capital on May 17, 2013.

could also ensure that supportive services are available to homeowners throughout the life of their mortgage. Post-purchase counseling has been found to increase the curing probability of delinquent borrowers; however, the success of this counseling is dependent on timing. Only counseling addressing an active delinquency situation has been found to be effective (Ding, Quercia and Ratcliffe 2008), suggesting that ongoing access is key. In light of this and other benefits represented by a comprehensive clearinghouse, we recommend that HUD leverage the effectiveness of the HAWK pilot by investing in enhanced delivery platforms and promoting stronger linkages between the many parties involved in the life of a mortgage.

4. Build in careful evaluation of outcomes.

As stated previously, the HAWK pilot represents a watershed opportunity to set new standards for housing counseling and education throughout the home buying process in terms of content, delivery and funding. As such, it is critically important that careful research is an integral part of the program; the learnings from the pilot could be its most valuable contribution.

An increasing commitment to homeownership counseling requires a corresponding shift in both the definition and scope of outcome measures examined. Data such as provider type, payee, method and quality of counseling as well as other factors including borrower characteristics, loan levels, and home values should be carefully tracked, and outcome measures should extend beyond default rates. A recent study by the Federal Reserve Bank of Philadelphia found that one-on-one counseling had a positive effect on the credit scores of both eventual homeowners and non-homeowners (Smith, Hochberg and Greene 2014). Researchers from the Center for Community Capital hypothesize that the Demonstration program will have similar outcomes; counseling participants are anticipated to see results such as increased personal savings and positive changes in attitude and behavior. It is reasonable to assume that the comprehensive homeownership counseling proposed by the HAWK pilot could have similar benefits extending beyond improved mortgage performance.

These broad outcome measures are significant, as it is important to acknowledge that not all those who undergo the first phase of counseling will end up with a FHA loan. Some may decide that homeownership is not the best decision for them, while others may end up with another form of financing. While these consumers will not qualify for the proposed basis point reductions, they still have the potential to gain valuable skills and knowledge through pre-contract counseling. Therefore we recommend that the value of the HAWK pilot for all stakeholders be measured to the extent possible.

The current HUD-funded Pre-Purchase Homeownership Counseling Demonstration and Impact Evaluation study is an important first step in this type of comprehensive, careful evaluation, and we recommend that the HAWK pilot be structured to build upon this work. The overall research question for this evaluation of pre-purchase housing

counseling is: *What impact does pre-purchase counseling have on mortgage preparedness, homebuyer outcomes, and loan performance for low- to moderate-income, first-time FHA homebuyers?* The study will make a direct and substantial contribution to the evidence on the impact of pre-purchase counseling. Whereas many of the previous studies have been limited by small sample sizes and non-experimental designs, this evaluation of pre-purchase counseling will recruit a large sample for a random assignment impact evaluation. The Center for Community Capital's ongoing analysis of outcomes from the study will provide an opportunity to more comprehensively measure the effects of homeownership counseling, addressing gaps in existing research.

Ultimately, evaluation of the HAWK pilot should focus not only on measuring the program's effectiveness but also on continuing to address gaps in knowledge regarding the value and impact of home ownership counseling. The potential to add to this knowledge extends the program's impact beyond the homeowners and lenders involved; moreover, this opportunity comes at a critical time of change and represents the possibility to significantly influence the residential mortgage industry as a whole. This unique opportunity for learning is perhaps the biggest contribution of the program, and we recommend that the HAWK pilot be launched with carefully considered, comprehensive evaluation tools in place.

As noted in the HAWK pilot description, marketing the program and building the capacity of the organizations implementing it will be critical to its success and its ability to generate important findings. The Center for Community Capital appreciates HUD's attention to this issue and shares in its ultimate goal of making responsible homeownership available and sustainable for all American families.

Thank you for your consideration.

Sincerely yours,

UNC Center for Community Capital
University of North Carolina at Chapel Hill

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