Commentary: How Housing Counseling, Financial Education, and Consumer Guardrails Can Support Responsible Borrowers

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The symposium in this issue of *Cityscape* shares timely research to inform housing policy and homeownership programs. Policymakers are concerned with the dilemma posed by historically low homeownership rates, on the one hand, and a fear of encouraging irresponsible borrowing and lending on the other. Two of the symposium articles shed light on consumer behavior toward mortgages and consumer credit, providing important insights as public and private policymakers look for new opportunities to help families build assets and modulate spending through the responsible use of credit.

Understanding and influencing consumer behavior around credit is extremely important (Durkin et al., 2014). The runup to the mortgage crisis featured excessive and inappropriate consumer debt; misunderstanding, misinformation, and fraud in credit transactions; and extensive miscalculation of the costs and benefits of debt. The overextension of credit and the ensuing defaults have consequences that are still felt by families, the financial industry, the global economy, and taxpayers.[1]

The improvement to the economy since the Great Recession officially ended in June 2009 is undeniable; however, the effects of the economic downturn are still with us. Since 2009, families have lost 6.2 million homes to foreclosure, and another 6.6 million families have received mortgage modifications in which a single missed payment could result in foreclosure. Indeed, more than 1,000 homes are still foreclosed on *every day*. Families affected by unemployment during the

[1] Families: See http://researchmatters.blogs.census.gov/2015/05/01/housing-crisis-and-family-well-being-examining-the-effects-of-foreclosure-on-families/.
Financial industry: See https://www.imf.org/external/pubs/ft/gfsr/2008/01/pdf/text.pdf.
Global economy: See http://www.economywatch.com/us-subprime/effects-banking-sector.html.
Taxpayers: See http://www.propublica.org/article/the-bailout-by-the-actual-numbers.

recession were often reemployed at significantly lower wages.[2] The monthly cost of many loan modifications is likely to rise because standard modifications are indexed to interest rates.[3] RealtyTrac recently estimated that about 3.3 million home equity credit lines totaling $158 billion and originated between 2005 and 2008 were still open and were scheduled to reset or begin amortizing between 2015 and 2018. For those loans, the average increase in monthly payments is estimated to range from $138 for loans resetting in 2016 to $161 for those resetting in 2018 (RealtyTrac, 2015).

Mortgage debt is not the only challenge that consumers face. Both student loan debt and credit card debt are at record levels. In the nation, more than $700 billion in total credit card debt is outstanding, meaning the average household carrying a credit card balance owes about $15,800 (El Issa, 2015). In 2013, nearly 70 percent of graduating college seniors carried student loans, with the average borrower owing more than $28,000 (Maloney, 2015). The ability of these households to live within their means and pay down their debt will determine whether they can afford suitable housing, rebuild their savings, and choose to access the myriad benefits of responsible and affordable homeownership.[4]

Congress has put in guardrails to protect consumers from excessive or inappropriate debt, including Dodd-Frank[5] reforms relating to the ability to pay, Qualified Mortgage rules for mortgage originations, and various credit protections such as the Credit Repair Organizations Act[6] and the Unfair and Deceptive Practices Act.[7] Caveat emptor, however, remains (and should remain) a fundamental principle of our economy, and no law ensures that a consumer receives the best-priced mortgage for his or her situation, or that he or she receives the most appropriate loan modification or most affordable path to resolve unpaid credit card debt. The consumer has a responsibility to shop around and become educated on the responsibilities of borrowing, and lenders should be rewarded for efficient business models and successful market innovations. For reasons explored in the following paragraphs, however, consumers encounter significant headwinds on their way to gaining unbiased information for optimal decisionmaking.

[2] For more information, see http://www.corelogic.com/about-us/news/corelogic-reports-37,000-completed-foreclosures-in-april-2016.aspx, http://www.hopenow.com/industry-data/HopeNow.FullReport.Updated_April2016.pdf, and Daly and Hobijn (2015).

[3] More than 500,000 Home Affordable Modification Program modifications, for example, had an interest rate reset in 2015. See http://www.dsnews.com/news/01-26-2015/can-hamp-borrowers-absorb-higher-payments-mods-reset. According to Black Knight Financial Services, Inc., the number of modifications facing a future interest rate reset is 2 million (Dayen, 2014).

[4] Homeownership also bestows a host of nonfinancial benefits on individuals and families. Research suggests that children who grow up in homeowning households perform better academically, are more likely to graduate from high school, and are less likely to become teen parents (Dietz and Haurin, 2003). In addition, studies have shown homeowners to be happier (Dietz and Haurin, 2003) and to have higher levels of satisfaction (McCarthy, Van Zandt, and Rohe, 2001) than similarly situated renters. It is not known exactly why homeowners are happier or more satisfied, but some potential reasons include greater feelings of control, the more desirable locations of owner-occupied properties, longer tenure, and the relatively limited tenants' rights in the United States.
The advantages of homeownership extend beyond the direct benefits to homeowners. Neighborhoods with high homeownership rates tend to have higher property values (Rohe and Stewart, 1996) and, as a consequence, higher levels of tax revenues. These resources can then be used to support community assets, such as schools, parks and recreational facilities, and public safety programs, that benefit all residents. The evidence also suggests that homeownership increases civic engagement, because homeowners are more likely to vote and volunteer in civic and philanthropic activities (McCarthy, Van Zandt, and Rohe, 2001).

[5] The Dodd-Frank Wall Street Reform and Consumer Protection Act. Pub. L. 111–203 (July 21, 2010).

[6] 15 U.S.C. § 1679.

[7] 15 U.S.C. § 45.

Two of the symposium articles in this issue of *Cityscape* document benefits of consumer protections or programmatic interventions in credit transactions and point the way for policies and programs that address the availability of consumer and mortgage credit, balance information asymmetries, and reduce risk for the family, the creditor, and neighborhoods and for city, regional, and national economies.

The article by Leslie Parrish is a deep dive into a market for "debt-settlement programs," a type of default resolution of outstanding credit card balances (Parrish, 2016). Debt settlement is offered by for-profit providers, unlike self-help direct negotiation with the creditor or nonprofit debt-management programs. Borrowers appoint the providers to settle debts with creditors on their behalf, through power of attorney and the payment of fees. The article analyzes 56,000 debtors' agreements to determine whether debt settlement improved or worsened borrowers' financial situation compared with common alternatives (negotiating directly with the creditor, entering a debt management plan, or filing for bankruptcy). Parrish finds that even after the Federal Trade Commission (FTC) implemented regulations designed to reduce abuses, consumers still received a negative outcome from selecting this mode of dealing with consumer debt.

This finding is all the more unfortunate when reliable (and more highly regulated) nonprofit options exist, such as U.S. Department of Housing and Urban Development (HUD)-approved housing counseling agencies and nonprofit credit counseling agencies. The Consumer Financial Protection Bureau (CFPB) provides a good comparison between credit counseling services and debt-settlement services.[8] Of course, their comparison chart not only points out the confusing nuances of a complex industry but also provides a guide to consumer vulnerabilities. The Parrish study describes an industry that profits by obscuring information and instead tells desperate people what they want to hear: that their problems will be solved without effort or cost. The fact that the "solution" is rarely effective is neither advertised nor discovered by consumers whose first wish, according to Parrish, is to stop the collection calls.

Neil S. Mayer and Kenneth Temkin's article explores a different type of intervention into the credit market—voluntary, nonprofit prepurchase housing counseling (Mayer and Temkin, 2016). Housing counseling agencies are nonprofit or government entities that provide independent, expert, and individualized assistance to help people achieve their housing goals and address barriers such as savings, credit, discrimination, or scams. Their research confirms that borrowers working with a nonprofit, HUD-approved housing counseling agency affiliated with NeighborWorks® America have better outcomes, including better loan performance and fewer defaults and foreclosures, than do similar borrowers who are not counseled.

What are some of the reasons that housing counseling is effective? First and foremost, these agencies educate consumers on the rights and responsibilities of homeownership and are forbidden by HUD regulations from steering consumers into a particular product or decision or from profiting personally from the consumer. Housing counselors view the consumer's decision to remain a renter as a win if that is appropriate for the family's situation. Housing counselors teach families to create a sustainable budget; to assess housing affordability within the confines of the household budget;

[8] See http://www.consumerfinance.gov/askcfpb/1449/whats-difference-between-credit-counselor-and-debt-settlement-company.html.

to address existing credit issues and understand how to manage credit; to shop for a home and a mortgage; to avoid fraud and discrimination; to understand the role of various housing professionals and how they are compensated; and to plan for emergency repairs and ongoing maintenance, insurance, and tax expenses. Default prevention and referrals to state and local resources are a critical part of HUD standards governing prepurchase education and counseling.

Mayer and Temkin find that "NeighborWorks® America's prepurchase counseling works" (Mayer and Temkin, 2016: 73). Counseled clients (both first-time homebuyers and repeat homebuyers) are one-third less likely to experience a 90-day delinquency within 24 months of loan origination compared with similar borrowers who were not counseled. This finding was consistent whether the loans were originated at the height of the mortgage boom in 2007 or at the height of constricted lending in the postcrash year of 2009. Income and past credit behaviors did not have the same impact as housing counseling on loan performance.

Both studies have impressively large data sets and explain their methodologies clearly. Each also has methodological shortcomings. Parrish's study uses a data set developed by a forensic accountant hired by an industry trade association to compare 56,000 consumers enrolled in debt settlement plans after an FTC regulatory change occurred. She compares actual results to predictive results based on a model of debt-settlement plan economics, and from that she assesses whether the decision to engage in debt settlement improved or worsened the borrowers' financial situations. Her assumptions are critical to the validity of her conclusions, and it is unclear whether other researchers can access the data set to replicate her results. She mitigates these concerns with what appear to be very conservative assumptions. Mayer and Temkin's study, with more than 75,000 clients, uses propensity scoring to correct for possible selection bias in the results, but it is not a true randomized experiment.[9]

We should not overstate these methodology questions; each study contains important insights into consumer behavior, and both should be used to inform policy decisions. Parrish's analysis of the business model of debt settlement points to many areas in which the consumer cannot have sufficient information to determine whether the advertised claims are valid nor ascertain the actual costs and risk of the program. Even if selection bias explains all the impressive results of housing counseling, it would still validate investment in greater access to and visibility for housing counseling to attract consumers who are unaware of the availability of this network but who would benefit if given the opportunity to self-select into a housing counseling program.

The authors point to many policy implications of their work. I note the following takeaways.

1. **Whom to trust?** Consumers need to trust service providers who have a duty to put their interests first, and they need to avoid misplaced trust. Legitimate and highly regulated nonprofit providers lack access to the marketing, advertising, and creative resources that attract the attention of consumers by contrast with debt-settlement providers who not only have advertising budgets but who also make claims that appear to push the envelope

[9] HUD is undertaking a true randomized, experimental demonstration of the long-term impact of prepurchase housing counseling and education on household outcomes. See DeMarco et al. (2016).

of FTC regulatory guidelines. One debt-settlement provider actually cautions consumers against reliance on what are described as misleading claims of an industry trade association that encourages members to display logos on their website: "Most consumers are under the impression that TASC (The Association for Settlement Companies) is some sort of regulatory organization, which it is not."[10] Government can perform an important service by promoting the use of regulated entities and by providing easy-to-access educational materials for consumers to help identify scams, red flags, and positive alternatives.

2. **Evidence matters.** Research results should be disseminated widely, not only through professional publications like *Cityscape* but also through social media and news outlets. Consumers can access simple tips through .gov websites, but these sites may not link easily to research that shows, for example, the effectiveness of HUD-approved housing counseling[11] or the relative ineffectiveness of debt-settlement agreements. Consumers need easy access to reliable information at the point in time when they are making decisions about credit products and services.

3. **Invest in the consumer guardrails.** The cost of public awareness campaigns and the cost of oversight by FTC, CFPB, and HUD are small compared with the cost to families, the economy, and society of a single foreclosure ($34,000; Apgar, Duda, and Gorey, 2005), failing to shop for the best-priced loan ($3,500; CFPB, 2015), or choosing an expensive and risky solution to resolve consumer credit balances ($9,107; Parrish, 2016). Increases in direct federal spending are unlikely, but policies to enforce responsible private payment, as Parrish suggests, are promising. Some lenders are unwilling to incorporate housing counseling into their services, perceiving it both as a competitive disadvantage (creating additional time and cost) and a barrier to a closing (for those originators whose business model depends on consumers' avoiding shopping for the best-priced mortgage or most-affordable home for their needs). All lenders, however, benefit from informed consumers who are prepared for the costs and responsibilities of homeownership. As the Bipartisan Policy Center's Housing Commission noted in 2013,

   > The Commission believes that housing counseling can improve borrowers' access to affordable, prudent mortgage loans, especially for families who might otherwise not qualify or who experience other barriers to mainstream lending. There is a wide public benefit from investment in housing education and counseling programs….
   >
   > Thanks to the infrastructure created by HUD, the counseling field will be able to maintain its depth and capacity. The HUD Housing Counseling Assistance Program is an excellent example of an effective and highly functional public-private partnership that should be thought of as a credit enhancer and important entry point for underserved communities to achieve homeownership. (BPC Housing Commission, 2013: 33, 35)

Caveat emptor exacts a high price in the consumer debt arena. A single mistake, such as an unaffordable mortgage product or attempting to resolve overextended credit lines, can have enormous consequences for borrower households on housing, education, employment, and health outcomes

[10] See http://damonday.com/270/the-association-of-settlement-companies-tasc-an-introduction/.

[11] See Myhre and Watson (2016).

for parents and children in addition to the direct consequences on assets, savings, disposable income, and credit scoring. Evidence-based policy can correct market information asymmetries while still protecting consumer choice and creativity in mortgage and consumer credit products.

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