

FEDERAL RESERVE BANK OF MINNEAPOLIS COMMUNITY AFFAIRS REPORT

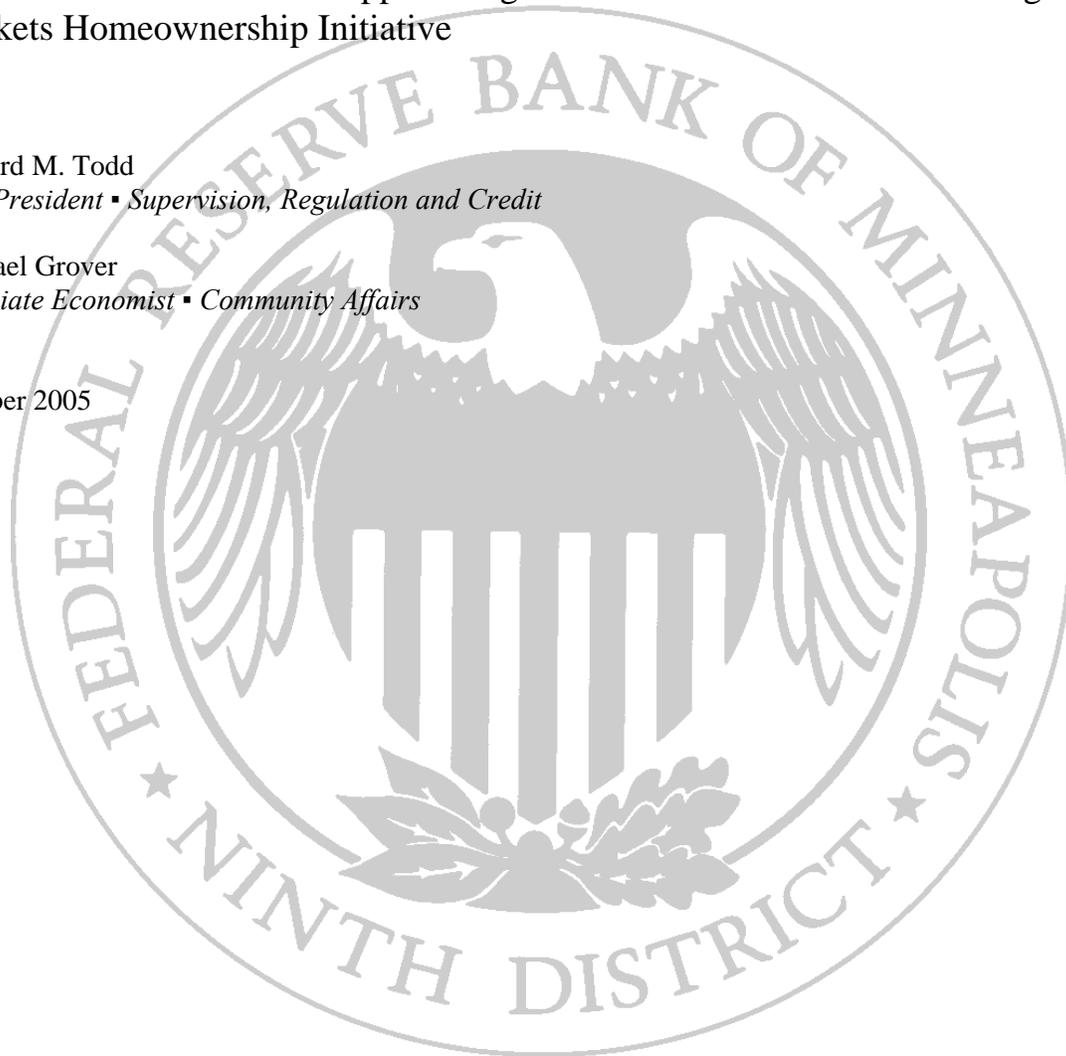
Report No. 2005-1

A Case for Post-Purchase Support Programs as Part of Minnesota's Emerging Markets Homeownership Initiative

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October 2005



A report series from the Community Affairs Department of the Federal Reserve Bank of Minneapolis.

The views expressed here are those of the authors and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System.

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By Richard M. Todd and Michael Grover

Introduction

The State of Minnesota’s Emerging Markets Homeownership Initiative (EMHI) seeks to boost homeownership rates among Minnesota’s “emerging markets,” defined as households of color, non-English speaking households, and households in which English is a second language. EMHI’s specific target is to boost the emerging markets homeownership rate in Minnesota from 42 percent in 2000 to 58 percent by 2012, as a step toward closing the large homeownership rate gap between this group and the state’s non-Hispanic white households.

Many of the implementation strategies in the *EMHI Business Plan* address general barriers to homeownership and should increase the number of emerging market households that become first-time homeowners. EMHI doesn’t stop there, however. It also recognizes the need to sustain homeownership after initial purchase, in keeping with growing evidence that the cliché “once an owner, always an owner” is far from true, especially for minority and low-income households. In particular, the *EMHI Business Plan* includes the following strategy:

Develop and implement a post-purchase services network to assure that emerging market homeowners have access to information and services pertaining to predatory lending and foreclosure prevention that will enhance their prospects for successful, sustainable homeownership.

Staff members of the Community Affairs unit of the Federal Reserve Bank of Minneapolis contributed to the development of this strategy and plan to assist in its implementation. As a foundation for the implementation effort, this report explains why Minnesota is in a good position to use post-purchase support programs (PPSPs) to pursue EMHI’s goals.

What are post-purchase support programs?

Despite its many attractions and advantages, homeownership brings financial and maintenance burdens that can challenge many families. The burdens tend to be more demanding for families with low or moderate incomes and other socioeconomic disadvantages, and currently those disadvantages are more prevalent among emerging market households. PPSPs aim to ease the burdens by offering homeowners training on home maintenance or household budgeting, counseling on emerging debt or mortgage payment issues, and—in some cases—financial assistance, such as temporary loans to buy time when foreclosure threatens. These services are often offered by nonprofit community organizations, with funding from financial institutions, foundations, governments, and individual contributors. Many lenders and local governments also offer PPSPs. Building on an existing network of Minnesota providers, EMHI's PPSP strategy is designed to hold down the incidence of foreclosures, including those resulting from predatory lending, as a way of boosting homeownership rates for emerging markets. However, the enhanced PPSPs could benefit Minnesotans generally, by cutting the public and private costs of preventable foreclosures.

PPSPs may cut the impact of mortgage foreclosures

Foreclosures can be costly for those directly involved and the general public. For borrowers, the costs can be substantial. In principle, a borrower could minimize his or her foreclosure-related financial losses. To do so, the borrower would calmly calculate whether the money owed exceeds the market value of the home. If it does, the borrower would accept foreclosure as a way of extinguishing the debt.¹ If it doesn't, the borrower would either find the money to maintain the mortgage payments or sell the house, using the bulk of the proceeds to pay off the mortgage and retaining the rest. However, consumers often don't behave that rationally, especially when under financial stress. Not surprisingly, foreclosure prevention counselors report that homeowners facing foreclosure are often very emotional, desperate, or unwilling to face their problems. These impressions are bolstered by the many documented cases in which homeowners in arrears agree to "foreclosure rescue" contracts that allow third parties to purchase their homes at far less than market value. In addition to clouding borrowers' financial judgment, emotional distress is itself a potentially significant cost of foreclosure for the borrowing family.

¹ As Cutts and Green (2004) stress, this strategy may not work if the borrower's state allows the lender to pursue a deficiency judgment for the balance of what is owed.

Lenders also frequently lose money in foreclosures, as compared to alternative means of resolving the debtor's problems, such as voluntary sale or debt restructuring. According to Collins and Nawrocki Gorey (2004, p. 2), "Lenders typically lose \$50,000 or more on a foreclosure, between payments, legal and other fees, and losses in the value of the property that serves as collateral for the loan." Partly for these reasons, many lenders have developed internal "loss mitigation" units or support third-party foreclosure counseling providers (Collins and Nawrocki Gorey 2004, p. 2; Toledano and Berry 2004).

Lastly, the public at large shares in the losses associated with foreclosures. According to a recent study of foreclosures in Chicago (Apgar and Duda 2005), the direct municipal expenses associated with a foreclosure are relatively small (a few hundred dollars) for an orderly foreclosure that doesn't result in a poorly maintained vacant property. However, in those cases where a prolonged vacancy occurs, direct municipal costs can quickly escalate into tens of thousands of dollars. Vacant or abandoned properties can also depress property values in their neighborhood. Such costs are one of the reasons the City of Chicago is also actively supporting an initiative to preserve homeownership in the city.

PPSPs have the potential to reduce foreclosures and their costs. There are two main types. One type, post-purchase training programs, aims to nip mortgage delinquencies in the bud by teaching new, at-risk homeowners how to manage their finances and efficiently operate and maintain their dwellings. The other type, foreclosure prevention counseling programs, takes over once a delinquency has occurred. The counselors help the borrower and lender arrange a mutually agreeable arrangement that avoids the excessive costs of foreclosure.

While there is ample anecdotal evidence that post-purchase training programs change homeowners' behavior in ways that make them more likely to meet their mortgage and related home-financing obligations, few rigorous studies exist. However, Hiram and Zorn (2001) make the case that quality training of homeowners before they buy significantly reduces mortgage delinquencies thereafter. It seems plausible that post-purchase training could reinforce and extend these benefits, which provides a basis for including post-purchase training programs in EMHI's PPSP strategy. Nonetheless, EMHI participants should also plan a strategy for assessing the effectiveness of such training programs.

Even with effective pre- and post-purchase training, some households will fall behind in their mortgage payments. When that happens, post-purchase counseling and foreclosure assistance programs have the potential to prevent many delinquencies from turning into foreclosures. Direct evidence on their efficacy is also limited, for obvious reasons. Few, if any, programs are willing to establish random control groups

of troubled borrowers who would have to be denied access to counselors. However, counselors for the Mortgage Foreclosure Prevention Program in Minneapolis and St. Paul, who have tracked counseling outcomes since 1991, report that about half of the delinquencies they handle are known to be resolved without a foreclosure (Home Ownership Center 2004, Tables 1 and 2). Chicago's Homeownership Preservation Initiative (HOPI) has reported 500 foreclosures prevented out of 1,535 cases counseled through Neighborhood Housing Services of Chicago from April 2003 to March 2005 (Neighborhood Housing Services of Chicago 2005, Tables 1 and 2).

Another sign that counseling succeeds in reducing avoidable foreclosures is that lenders support it, both through their internal loss mitigation units and through financial and other support they provide to third-party counseling programs like HOPI. Cutts and Green (2004, pp. 13–16) summarize the technological changes in the mid- to late 1990s that allowed lenders to better identify problem loans at an early stage, further identify those most able to repay, and then customize suitable arrangements for repayment. As a result, lenders' loss mitigation activities expanded rapidly in the late 1990s. According to Cutts and Green (p. 23), that helps explain why foreclosure rates did not rise significantly in the ensuing recession.. Based on their study of 148,050 loans that entered delinquency in 2001 (p. 22), they believe that “repayment plans ... work very well at keeping delinquent borrowers in their homes.”

... and cut homeownership gaps, too

EMHI is betting that PPSPs can significantly lower the incidence of foreclosure in Minnesota. Implicitly, it also assumes that PPSPs will have a material impact on Minnesota's emerging markets homeownership gap. Recent research suggests they might.

Minnesota's homeownership gaps are indeed large. According to the Minnesota Housing Finance Agency (MHFA), 77 percent of Minnesota's non-Hispanic white households were homeowners in 2000, compared to 32 percent of African American households, 49 percent of American Indian and Alaska Native households, 52 percent of Asian American households, and 43 percent of Hispanic households. The resulting homeownership gaps of up to 45 percentage points are mostly above the corresponding national figures. Todd (2005) and the *EMHI Business Plan* discuss some of the factors behind these gaps. Whatever explains the gaps, EMHI's goal is to reduce them by boosting emerging market ownership rates.

An important part of reducing the gaps is to put emerging market households in a better position to buy their first homes. Although elimination of racial and ethnic gaps in general education and earnings is the best long-term solution, initiatives to those ends are generally beyond the scope of housing programs like EMHI. Instead, these programs have traditionally focused on initiatives within the housing market, such as information dissemination, enforcement of antidiscrimination laws, homebuyer education, repair of problems in credit reports, downpayment assistance, flexible mortgage products, and more. Since minority households are less likely to ever buy a home—and, if they do buy, tend to do so at later ages—housing programs that help low-income and minority households achieve first-time homeownership make sense as a strategy for reducing Minnesota’s emerging markets homeownership gap.

However, recent studies confirm that households differ significantly not only in attaining homeownership, but also in sustaining it. Using data on a sample of households from 1968 to 1993,² Reid (2004) found that 40 percent of long-term renters³ who bought a home between 1976 and 1989 returned to renting at least once by 1993. However, the odds of exiting homeownership were higher for low-income households; 36 percent exited homeownership within two years, and 53 percent exited within five years. Comparable figures for high-income households were much lower, at 12 and 23 percent, respectively. For low- and moderate-income households, homeownership exit was especially high in the first three years after purchase and then gradually, but steadily, declined. Reid also showed that within each of her income groups, minority households were more likely to exit homeownership in any given post-purchase year. Over 40 percent of low-income minority homebuyers were no longer owners after two years, compared to less than 30 percent for low-income non-Hispanic white households.

Haurin and Rosenthal (2004) reached similar conclusions based on a sample of individuals followed from youth (ages 14 to 21) in 1979 to middle age in 2000.⁴ Over the sample period, 63 percent of the African American individuals owned a home at some point, but only 34 percent still did as of the final year, 2000. The comparable figures for non-Hispanic whites were 88 and 69 percent. That is, whites were much more likely to buy at some point and experienced less cumulative reversion to non-owning as of 2000. Although the eventual incidence of exits for first-time homeowners was roughly equal across racial and ethnic groups (45 percent left homeownership at some point), the total duration of homeownership differed. After adjusting for missing data, Haurin and Rosenthal estimate that first-time homeownership for non-Hispanic whites typically lasted 16.1 years, while for African Americans it typically lasted just

² The Panel Survey of Income Dynamics.

³ Renters who had not owned a home for at least five years before entering the sample.

⁴ The National Longitudinal Survey of Youth.

9.5 years.⁵ Like Reid, Haurin and Rosenthal also find that the odds of exiting homeownership are highest in the early post-purchase years, peaking at 10.5 percent in the first year for first-time buyers.

To illustrate how differences in sustaining homeownership can affect homeownership gaps, consider the experience of two individuals, following them from the ages of 20 to 45. Suppose both buy their first home at age 30. One sustains ownership through age 45, while the other returns to renting at age 39. The first individual owns for 15 out of the 25 years from ages 20 to 45, or 60 percent of the time. The other owns for 9 years out of 25, or 36 percent of the time. The difference in the duration of their first-time homeownership experience results in a significant homeownership gap between these individuals, and it can have the same effect on groups of individuals who differ, on average, in the same way. Haurin and Rosenthal conclude that “policies that lengthen existing ownership spells also will raise the national ownership rate” (p. 50).

Can PPSPs that serve Minnesotans without regard to race, ethnicity, or language shrink Minnesota’s emerging markets homeownership gaps? Reid (pp. 21–25) and Haurin and Rosenthal (pp. vi–viii) identify factors that increase the likelihood of a household exiting homeownership: low income; low education; low levels of general knowledge (as measured by a standardized test⁶); relative youth; being single, divorced or separated; and living in a central city or rural area. PPSPs could be targeted based on attributes like these, independent of race or ethnicity. To the extent that Minnesota’s emerging market populations experience a disproportionately high prevalence of the selected targeting factors, these PPSPs would tend to reduce Minnesota’s homeownership gaps. Since emerging market households are, on average, disproportionately more at risk for delinquency, even untargeted PPSPs serving all delinquent borrowers equally should help reduce the gaps.

A good place and time to implement PPSPs

Minnesota is in a good position to implement EMHI’s PPSP strategy, for at least three reasons.

First, Minnesota is nationally recognized for the quality of its existing PPSPs. MHFA coordinates the statewide Foreclosure Prevention and Assistance Program, which was recently featured in an analysis of U.S. foreclosure prevention programs. As part of the statewide effort, the Home Ownership Center

⁵ The estimates for Hispanics are intermediate between those for non-Hispanic whites and African Americans. However, their sample includes only Hispanics already present in the U.S. as young adults in 1979 and thus fails to capture any of the large wave of Hispanic immigrants who arrived after that year.

⁶ The Armed Forces Qualifying Test, which measures general knowledge retained from elementary and high school.

(HOC), recently cited in a review of the “essential components” of model PPSPs (Baker 2004), coordinates the Mortgage Foreclosure Prevention Program in the core cities of Minneapolis and St. Paul. Under this program, three agencies—the City of St. Paul, Twin Cities Habitat for Humanity (for South Minneapolis) and the Northside Residents Redevelopment Council (for North Minneapolis)—have provided foreclosure prevention counseling for over 10 years and, in the process, assembled one of the nation’s best databases on counseling cases and outcomes. Based on this data, the Twin Cities-based Family Housing Fund (FHF) has sponsored innovative research on the effects of foreclosure prevention counseling (Quercia, Cowan, and Moreno 2004).

Another key component of the statewide programs is the high-quality training and certification provided to Minnesota’s foreclosure prevention counselors through the Minnesota Mortgage Foreclosure Prevention Association (MMFPA). Minnesota also has excellent models for post-purchase training programs, such as those offered by Neighborhood Housing Services of Minneapolis. In addition, the Twin Cities has an award-winning Don’t Borrow Trouble campaign that offers guidance and referrals to help homebuyers avoid predatory lending and mortgage financing problems. Don’t Borrow Trouble Minnesota, administered by FHF, has a strong coalition of over 60 partners, more than 20 of whom help fund the campaign, and a referral network of 14 housing organizations. Many other examples could be listed.

Second, Minnesota can take advantage of innovations that have emerged in other parts of the country. Collins and Nawrocki Gorey (2004) and Baker (2004) provide several examples. One is the Pennsylvania Housing Finance Agency’s Homeowners’ Emergency Mortgage Assistance Program, which has over 20 years of experience in providing financial assistance to delinquent borrowers according to specified hardship and recovery criteria. In Chicago, the HOPI effort has promoted stronger working relationships among national mortgage lenders and servicers, local foreclosure prevention programs, and local governments (Toledano and Berry 2004).

Lastly, EMHI provides a framework for building upon the existing strengths of Minnesota’s PPSP network. The HOC has been selected as the lead convener for implementing EMHI’s PPSP strategy. Assisting as primary conveners will be FHF, Greater Twin Cities United Way and MMFPA. Additional participants already enlisted include the Mortgage Association of Minnesota and the Federal Reserve Bank of Minneapolis. Details are available in the *EMHI Business Plan* at www.mhfa.state.mn.us/about/EMHI_Business_Plan.pdf.

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