Strengthening Neighborhood Stabilization: Refining Business Models for Housing Counseling

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The connection between property acquisition and housing counseling in neighborhood stabilization efforts may seem obvious in 2013, but in the early years of the housing crisis, it was not. Even within organizations that provided both housing development and counseling services, there was often little or no interaction between the two departments. But if the last five years have taught the affordable housing industry one thing, it is that there is immense value both for homeowners and for the broader mortgage market in embedding nonprofit housing counseling into neighborhood stabilization efforts.

Since 2007, housing counselors have served as trusted advisors for millions of troubled borrowers. Through targeted outreach programs, counselors have helped public entities and private mortgage lenders reach distressed borrowers and improve loan outcomes. Indeed, a suite of new academic and practitioner studies documents the economic and social value of housing counseling.[1] In its evaluation for Congress, for instance, the Urban Institute found that borrowers who received counseling under the National Foreclosure Mitigation Counseling Program were twice as likely to obtain a loan modification and 67 percent as likely to remain current on the mortgage nine months later, compared with counterparts who received modifications without the assistance of a counselor.[2]

Although the value of counseling is often acknowledged, the notion of fully integrating housing counseling into neighborhood stabilization efforts is not typically part of the conversation. During the past few years, the Housing Partnership Network's (HPN) Innovations in

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1 NeighborWorks America, "National Foreclosure Mitigation Counseling Program: Congressional Update" (Washington, DC: NeighborWorks America, June 2012), available at www.nw.org/network/nfmcp/documents/2012CongressionalReport.pdf; J. Michael Collins and Maximilian D. Schmeiser, "Effects of Foreclosure Counseling on Distressed Borrowers," Journal of Policy Analysis and Management 32:1, 2013; U.S. Department of Housing and Urban Development, "Foreclosure Counseling Outcome Study: Final Report, Housing Counseling Outcome Evaluation." (Washington, DC: HUD, Office of Policy Development and Research, May 2012), available at: www.huduser.org/publications/pdf/foreclosure_counseling_v2.pdf ; J. Michael Collins, "The Role of Default Counseling for Mortgage Borrowers in Financial Distress," *Consumer Knowledge and Financial Decisions,* International Series on Consumer Science, Douglas Lamdin, ed. (pp. 165-82) (Rueil-Malmaison, Germany: Springer, 2012); Neil S. Mayer and Kenneth Temkin, "Pre-Purchase Counseling Impacts on Mortgage Performance: Empirical Analysis of NeighborWorks® America's Experience." (Albany,CA: Neil Mayer and Associates, 2013), available at www.nw.org/network/newsroom/documents/ExperianMayer_FullReport.pdf.

2 NeighborWorks America, "National Foreclosure Mitigation Counseling Program."

Neighborhood Stabilization and Foreclosure Prevention Initiative has been piloting new models that have taken the idea further by embedding counseling directly into new models, and engaging housing counselors as essential partners, rather than adjunct social service providers. The implications of this are significant; to capture the full economic and social benefit of housing counseling (both to the homeowner and the asset holder), it is essential to reframe and refine the counseling business model and delivery system to reflect the full value of the services. What's more, in the wake of severely constrained and diminished public funding for the industry, this kind of business model transformation may be key to sustaining the housing counseling industry going forward.

This article begins by reviewing the evolution of the housing counseling industry and discussing the opportunities and challenges of adopting a "fee for service" model of housing counseling. We then highlight two recent business model innovations that have emerged in response to the foreclosure crisis–the Mortgage Resolution Fund in Chicago and the Occupied Homes Program in New York City. Through HPN peer exchange, nonprofit organizations working on both the supply and demand sides of stabilization efforts–including developers and housing counseling providers–were able to better understand how their efforts were intertwined. The discussions led to new, more collaborative social enterprise models for neighborhood stabilization. In the Mortgage Resolution Fund and the New York Occupied Homes Program, housing counseling is explicitly incorporated to fully capture the value and expertise that counselors bring to the loss mitigation process. Moving forward, developing new methods of delivery to bring the industry to scale may be an essential component of long-term housing market sustainability.

The Evolution of the Counseling Industry

Counseling programs have long been part of homeownership and foreclosure prevention strategies. The U.S. Department of Housing and Urban Development (HUD) began funding housing counseling organizations through the Housing Counseling Assistance Program 50 years ago. When the program was enacted in 1974, the focus was on home retention. This shifted in the late 1980s and early 1990s as lenders began to use pre-purchase homeownership education and counseling to screen individuals and reduce risk.[3] Pre-purchase counseling thus became part of a menu of services and innovations designed to improve access to credit for historically underserved populations. Nonprofits that provided housing counseling services helped to build a pipeline of mortgage-ready borrowers for down payment assistance and other affordable homeownership programs. Inherent in the move to expand pre-purchase counseling programs was the recognition that they reduce risk and add value to the mortgage market. However, there was still no definitive proof that counseling "worked." Or, at least, there was not enough proof to justify paying for the cost of counseling as part of a mortgage contract.

3 Steven Hornburg, "Strengthening the Case for Homeownership Counseling: Moving Beyond a Little Bit of Knowledge." (Washington, DC: NeighborWorks America, 2004).

The housing crisis that began in 2007 precipitated rapid changes in the counseling industry. Once the magnitude of subprime delinquencies became apparent, the demand for foreclosure prevention counseling skyrocketed. In December 2007, Congress authorized $180 million for a National Foreclosure Mitigation Counseling (NFMC) Program, which enabled local agencies to ramp up staff and resources to respond to the demand for their services. Organizations that had established homeownership counseling programs to help people purchase homes had to retool quickly to advise clients on how to pursue loan modifications and prevent default.[4] These organizations have since been at the front lines of myriad public programs, particularly federal initiatives, related to loss mitigation and neighborhood stabilization. They include:

- In 2008, the Housing and Economic Recovery Act, which authorized an additional $180 million for NFMC and $3.9 billion for the Neighborhood Stabilization Program;
- In 2009, the Financial Stability Act, which created the Making Home Affordable Program that included the Home Affordable Modification Program (HAMP);
- In 2010, Hardest Hit Funds, which provided $7.6 billion to 18 "hardest hit" states, plus the District of Columbia, to support locally tailored programs to assist struggling homeowners;
- In 2011, the Emergency Homeowner Loan Program, which provided funds similar to the Hardest Hit Fund in the remaining states; and
- In 2013, the Making Home Affordable Outreach and Intake Program, which provides funding to housing counseling organizations for HAMP outreach and packet submission.

HUD also began to prioritize loss mitigation efforts in its Housing Counseling Assistance Program, first by allocating increased funding to foreclosure prevention, and then by implementing the Mortgage Modification and Mortgage Scams Assistance program. Through these initiatives, counseling agencies became the go-to providers for services ranging from outreach for at-risk borrowers, to document collection and modification package submission, to connecting clients to emergency, legal, and employment services. The new resources were instrumental in enabling counseling organizations to meet increasing demand for foreclosure counseling.

However, these programs also introduced new challenges for the industry. For example, each program had its own reporting and filing requirements. In addition, there were significant prohibitions against combining funding sources. Although the funds from the NFMC program were never intended to cover the full cost of service provision, and were instead

4 As the first national HUD Housing Counseling Intermediary, designated as such in 1994, the developments of the last five years have directly affected the Housing Partnership Network and our 30 members who provide housing counseling services. The infusion of NFMC funds into our network increased foreclosure counseling production by 200 percent.

intended to supplement other funding sources,[5] HUD nonetheless prohibited leveraging NFMC funds to cover the cost of providing foreclosure counseling services with HUD Housing Counseling funds. The impact of this prohibition on counseling organizations was significant. As a program director at one HPN member expressed, "Counseling is a loss leader. We have to constantly supplement the program with profits from our other programs to keep it running while at the same time we leave money on the table with our federal grants. For a foreclosure counseling case that took us 40-plus hours to complete, the [NFMC funds] only cover the first 10 hours. The federal funds we were not able to [leverage] could have covered the cost."

In addition to inefficiencies in the myriad grant rules, the new programs were challenging to manage because each program depended heavily on housing counselors to understand–and explain to borrowers–its unique requirements, all the while negotiating with servicers who were often responding to a different set of incentives and constraints.

Moreover, and perhaps more important, even in the midst of an unprecedented housing crisis, federal funding for housing counseling has been precarious at best. The HUD Housing Counseling Program was zeroed out of the 2011 Continuing Resolution, temporarily cutting off funds to the program entirely. Sequestration has further threatened the viability of housing counseling programs, and it is unclear whether the current Congress will further cut HUD's counseling budget going forward.

The fact that an essential funding source could be eliminated in the middle of a crisis underscored the need for the counseling industry to diversify and lessen its reliance on federal grants. Public funding is unlikely to remain high enough to support the growing demand for counseling, which remains strong as the foreclosure crisis continues and aspirations for homeownership remain strong.

Fee-for-Service: A Step in the Right Direction

These three challenges–multiple grant revenue streams, programmatic inefficiencies, and insecure funding–underscore the need for the counseling industry to decrease its reliance on federal grants and generate new revenue sources. The fee-for-service model–or, paying a fee per service provided–has long been discussed as a potential route for the housing counseling industry, rather than continuing to rely on grant funding. However, until recently, this model has been difficult to implement.[6] This changed when the American Securitization

5 National Foreclosure Mitigation Counseling Program, Round 7 Funding Announcement, page 3: "The intent of NFMC Program funding is to expand and supplement counseling services available to families facing default and foreclosure. It is expected that eligible Applicants will make every effort to receive reimbursement for counseling services from other sources, such as investors and/or servicers, to increase the sustainability of these services. NFMC Program funds are not meant to replace current or future fee-for-service arrangements between counseling agencies and servicers, lenders, or other interested parties." http://nw.org/network/foreclosure/nfmcp/documents/I.FundingAnnouncement-Round7_001.pdf

6 The original concept for the NFMC program was a fee-for-service model. Although it was ultimately funded through federal grants, via NeighborWorks America, the NFMC program built the substantial evidence that the counseling industry needed to secure fee-for-service contracts.

Forum announced that counseling fees could be reimbursed from securitization transactions in appropriate circumstances.[7] As a result, several small fee-for-service relationships emerged between investors, servicers, and housing counseling intermediaries. In a typical fee-for-service arrangement, servicers agree to pay a flat fee to agencies for counseling their borrowers, identifying specific reimbursable services such as helping the borrower complete an application package for a loan modification.

The emergence of fee-for-service arrangements led to several improvements in the counseling process. Throughout the crisis, the relationship between counselors and servicers tended to be antagonistic rather than collaborative. Under fee-for-service contracts, these relationships improved, given that participating counselors were more likely to have access to an identified contact person at the servicer to provide training and answer questions regarding an application for a loan modification. In addition, contracting with servicers has required some counseling organizations to improve their business functions, such as information technology and insurance, to comply with bank rules. Servicers have also improved systems to enable better exchange of information. For example, many counselors are now able to use electronic portals to directly submit borrower applications rather than using cumbersome and unreliable faxes that previous servicers required. In certain markets with limited grant funding, fees have also served to support growing counseling efforts.

However, the structure of fee-for-service contracts has its limitations, both in achieving borrower outcomes and in generating revenue for a counseling organization. Despite often having a better relationship with the servicer, counselors' effectiveness is limited because they remain detached from the actual business transaction and modification decision. For instance, privacy laws prevent counseling agencies from conducting direct borrower outreach. In addition, once a borrower is contacted, the counselor does not have access to investor guidelines that dictate the terms that would be acceptable for loan modification. As a result, counselors may be unable to negotiate effectively on behalf of the client to find a solution that is preferred for the investor. Moreover, if the loan modification is denied, the counselor cannot explain the reason for the denial to the borrower, as they are only told that the denial is "due to investor guidelines" without further explanation.

It is also unclear whether current fee structures are sufficient to support the wide range of services the nonprofit organization provides. Even if a borrower is granted a loan modification, the fee paid by the servicer generally does not cover the intensive financial counseling, budgeting, and follow-up needed to ensure that the homeowner stays current with his or her mortgage payments. When families are unable to remain in their homes, housing counselors still shoulder the burden of finding alternatives after foreclosure. The contract fee does not cover these services. In fact, the flat fees often do not cover the full cost of counselor time for even the most straightforward loss mitigation transaction. Although counseling agencies will continue to form strategic relationships with servicers, fee-for-service arrangements have not proved the cure-all the industry imagined.

7 For full Alliance Action Plan, see http://www.hopenow.com/alliance-statement.php

The Mortgage Resolution Fund: Linking Counseling to the Value of the Asset

Lessons learned from fee-for-service relationships have led to innovations in response to the foreclosure crisis. One key innovation is integrating the housing counseling model more deeply into the mortgage transaction by creating a direct link between the benefits of counseling and the returns to the investor. The model is based on the principle that preventing default is more efficient and cost-effective than allowing the foreclosure to take place. In this model, rather than the counselor contracting with the servicer–who is in fact just a middle man in the transaction–the counseling agency is directly linked to the investors through the loss mitigation process. This model is being piloted as part of the Mortgage Resolution Fund (MRF), which was founded in March 2011 by Mercy Portfolio Services, the National Community Stabilization Trust, Enterprise Community Partners, and HPN.

Using Hardest Hit Funds and leveraged pools of capital, MRF purchases delinquent notes from the investor at a discount, right-sizes the mortgages, and offers genuine principal reduction in conjunction with intensive financial coaching. As a nonprofit, mission-driven investor, MRF can control the loss mitigation process, ensuring that families who are underwater (owing more than their home is worth) but who could otherwise afford their mortgage are able to do so. Both borrowers and lenders benefit from reduced financial loss, as do neighborhoods.[8]

MRF is innovative from a variety of perspectives, but one key to its success is the full integration of housing counseling into the program through the Resolution Specialist model. Resolution Specialists are employees of a nonprofit organization with a history of providing a range of homeowner supports, affordable lending, and other related services. The Resolution Specialist is directly linked to the "asset" side of MRF; the counselors have access to loan data before they even speak with a client, and they are able to initiate direct contact with both the investor and a designated team at the servicer. In contrast to a traditional loss mitigation model, Resolution Specialists do not have to wait until a client contacts them. In addition, because Resolution Specialists screen applicants and explain eligibility criteria, they have direct access to investor guidelines that dictate eligibility. This is unprecedented for the counseling community. If an aspect of eligibility is unclear, Resolution Specialists can call a MRF team member at the servicer or investor staff to gain clarification. Resolution Specialists also participate in weekly calls with the servicer and MRF staff to review the case pipeline.

In spring 2012, MRF partnered with the Illinois Housing Development Agency (IHDA) to develop a pilot program in the Chicago area.[9] Using Hardest Hit Funds, IHDA agreed

8 Geoff Smith and Sarah Duda, "Left Behind: Troubled Foreclosed Properties and Servicer Accountability in Chicago." (Chicago: Woodstock Institute, January 2011).

9 Illinois was a logical place to pilot MRF for a variety of reasons. In August 2012, Illinois posted the highest rate of foreclosure in the country—one in every 298 houses was in foreclosure. Unlike many other parts of the country, foreclosures had actually increased by 33 percent over the previous year. Strong local capacity also exists in Chicago. Neighborhood Housing Services of Chicago has served thousands of homeowners at risk of foreclosure in the Chicago region through its homeownership counseling services. Working to revitalize Chicago communities since 1975, the organization has a track record of achieving excellent outcomes for its clients.

to provide an initial investment of up to $100 million to purchase delinquent mortgages and improve borrower and neighborhood outcomes. In Illinois, Resolution Specialists are employed by Neighborhood Housing Services of Chicago, a local community development financial institution (CDFI) that has long provided homeownership counseling services. Under contract with MRF, the Resolution Specialist is responsible for building and implementing an Individual Program Plan for each borrower using MRF guidelines. MRF looks to the expertise of the Resolution Specialist to determine the plan for each borrower and to assist in bringing secondary debt under control.[10]

In summer 2013, the Mortgage Resolution Fund expanded to purchase mortgage notes in Northeast Ohio, bringing the total pool to 1,350. The mortgages in the Ohio pool are up to three years delinquent. Some borrowers had already received foreclosure notices at the time that MRF acquired the note.

Despite the odds stacked up against preventing foreclosure for these borrowers, initial results from the loan pool purchases have been extremely encouraging. Homeowners respond in higher numbers to the MRF Resolution Specialists than to traditional loan servicers who may have contacted them in the past. Of the total pool of families holding delinquent notes in Illinois and Ohio, nearly 70 percent have had contact with a Resolution Specialist, compared to an industry standard in the range of 30-40 percent. Results also suggest that the MRF loan modification rate is higher when a Resolution Specialist is involved in the process. Of the MRF households contacted, nearly 80 percent have modified their loans, entered into short sales or deeds in lieu, or relocated to more appropriate housing options.

The individual anecdotes coming out of MRF in Illinois and Ohio tell an even more compelling story than the statistics alone. One MRF borrower was previously unable to establish a modification with her servicer despite several attempts to do so, after she was hospitalized and her son became ill. As a MRF client she was eligible for a "right-sized" mortgage that she could afford and entered into a modification, which brought stability to her life and allowed her to remain in her home. A second MRF borrower suffered from the loss of her spouse's income after a divorce, and had only child support as her income. She was repeatedly denied modification approvals and lost $1,500 to a loan modification scam. Eager to put her financial troubles behind her, with MRF she was able to work with a Resolution Specialist to voluntarily enter into a deed in lieu of foreclosure. Relieved of her mortgage obligations, she was able to move forward with her life after this crisis.

One of the most promising outcomes of the MRF program thus far is the true sustainability of the restructured mortgage. As of November 2013, 91 percent of MRF borrowers

10 The standard is a 31 percent/45 percent front-end/back-end debt ratio that will support the homeowner's ability to stay in the home with a new mortgage at the reduced principal. Once MRF owns the note, the Resolution Specialist can recommend a trial modification or alternative disposition depending on the household's financial situation. Options may include a short sale or deed in lieu of foreclosure, with foreclosure only as a last resort. If borrowers are approved for a trial modification, they receive an action plan to reduce back-end (non-mortgage) debt and financial coaching during a 6- to 24-month period until the household is eligible for a permanent loan modification. Borrowers become eligible for a permanent modification after making on-time payments and by bringing down back-end debt to an affordable level. If a borrower's financial situation does not allow for a trial modification, the Resolution Specialist will work through the transition to more affordable housing.

approved for a trial modification in Illinois are sustaining their mortgage payments, including 14 percent who have already converted to a permanent modification. The ability to sustain homeownership once a mortgage is right-sized is an outcome that has implications beyond the MRF model, for the broader mortgage industry.

The Occupied Homes Program: Embedding Housing Counselors

Another new model is the Occupied Homes Program (OHP) in New York. This program is composed of the Neighborhood Housing Services of New York City, the New York Mortgage Coalition, and the Long Island Housing Partnership. Its goal is to help underwater homeowners who have endured a recent hardship to stay in their home. The consortium of New York area organizations has created a pilot project to keep families in place while converting nonperforming assets to affordable and viable mortgages. Specifically, the program encourages servicers to offer structured short sales or identify candidates for principal reductions that could be offered under mortgage settlement agreements.

The program purchases the note at the current market rate and rents the home back to the household. The family is able to stay in the home while they receive intensive financial coaching from a HUD-certified housing counseling agency. The rent is equal to the new principal, interest, taxes and insurance of the newly adjusted mortgage. The family demonstrates they are able to afford the new mortgage with this new payment history. If the household meets underwriting criteria and makes 12 consecutive on-time payments, they may repurchase the home under the program's mortgage terms.

As in MRF, housing counselors play a critical role in the OHP model. They identify potential participants from existing client pipelines, and counselors work to determine if a current homeowner can afford the adjusted mortgage payment. Once a participant enters the program, housing counselors seek to resolve financial issues impeding sustainable homeownership. Counseling services are critical to ensuring loan performance, thereby providing significant value to both the investor and the homeowner.

Conclusion

It is unclear what the future of the housing counseling industry will look like, but increasingly, there is recognition of its value. For example, in its 2013 report, the Bipartisan Policy Center's Housing Commission called for an "entirely new system of housing finance," and declared that housing counseling and education must be central to any sustainable homeownership strategy. The report stated that more could be done in the pre-purchase counseling arena to build on models of lender-counselor partnerships. "Lenders, investors, and regulators could provide counseling incentives for borrowers on the margins of creditworthiness."[11] In addition, the Consumer Financial Protection Bureau in its new rules regarding high-risk mortgages has underscored the importance of counselors to the industry. Starting in January 2014, before lenders make a high-cost loan, they must certify that the consumer has received

11 Bipartisan Policy Center, "Housing America's Future: New Directions for National Policy" (Washington, DC: Bipartisan Policy Center, February 2013), p. 35.

"homeownership counseling" that specifically discusses the high-cost product the lender is offering the consumer.[12] HUD is also exploring strategies to integrate housing counseling into FHA lending.

What is harder to foresee is how the counseling industry will evolve given fiscal constraints, and how it can be structured to achieve greater scale. The Commission posited that the stakeholders who benefit from counseling should pay for it.[13] However, this means that the industry must improve its ability to identify and market to customers, whether they are homeowners, lenders, servicers, or rental property managers, as well as demonstrate its return on investment. Efficiencies in the way products are delivered must be created.

One solution may be to take advantage of technology to increase scale and maximize efficiency. HPN, together with its member the Minnesota Homeownership Center, has developed and recently launched Framework®, an online homebuyer education tool that is interactive, fun, and adheres to the National Industry Standards for Homebuyer Education curriculum. Framework is an example of a low-cost approach to providing counseling services, and the online platform may be more effective at reaching populations who face challenges attending in-class sessions.

But the hope is that the Mortgage Resolution Fund and the Occupied Homes Program in New York will also demonstrate the value of embedding counseling into all of the steps of a mortgage transaction. By fully integrating counseling into relevant financial products and social enterprise models, the scale of counselors' impact is vastly increased, leading to better outcomes for individual households, investors, servicers, and communities.

Danielle Samalin, Vice President of Homeownership Initiatives at the Housing Partnership Network, oversees the Network's housing counseling and foreclosure prevention efforts, with a specific focus on new business innovations in counseling such as the Network's online homebuyer education tool, FRAMEWORK®, and the Resolution Specialist component of the Mortgage Resolution Fund.

12 Consumer Financial Protection Bureau, "What the New High-Cost Mortgage Protections Mean for Consumers" (Washington, DC: CFBP, January 2013), available at http://files.consumerfinance.gov/f/201301_cfpb_high-cost-mortgage-rule_what-it-means-for-consumers.pdf

13 Bipartisan Policy Center, "Housing America's Future," p. 10.