THE
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Extending Homeownership

Street Level Lenders Discuss What Works and What Doesn't

CRA and a national spotlight on homeownership have encouraged lenders to extend their services to a wider range of first-time and low to moderate income homebuyers than ever before. The Chicago Rehab Network invited street level loan officers from Chicago banks to discuss recent developments. We asked them about the obstacles they see low income families facing as they struggle to become homebuyers, and to what extent these obstacles can be minimized without sending families on their way to default. They said they were glad we asked.

"What has changed in lending to first-time and low to moderate income homebuyers in the past one to two years?"

As the conversation opened, the key words were flexibility and incentives.

Leony Tavas Scott of First National Bank of Chicago explains that the recent changes she's seen have less to do with relaxing the underwriting guidelines that determine who qualifies for a mortgage - "I think we've dealt with that" - and more to do with the pricing. "It's the incentives part of the package, and what you're willing to add to the pot."

Calvin Ward of Northern Trust agrees. "The general homebuyer asks 'What do you have to offer me as a first time homebuyer?' and you find yourself bringing out this long list of incentives."

Carl Pietraszewski of LaSalle Home Mortgage Corporation says he is willing to mix and match features from different programs. "It's not where if you don't fit into a box, you're out."

"That's why you end up with several variations," Estella Porter Pruitt of Harris Trust agrees. "You'll take a first time homebuyer with a low downpayment going into it, if they also make a certain amount of money."

Why such accommodation? "Competition," Carl says simply.

"In the past, these loans have proven to be profitable," Estella says.

"What changes do you anticipate in the next 1 to 2 years?"

The comments became a little more stern. No one thought we'd see underwriting guidelines relaxed any further, for instance.

"It's relaxed," Kein Burton of Old Kent Bank says. "It's relaxed

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The Chicago Collaborative: Setting Standards for Homebuyer Education

Homebuyer education and counseling may be the single factor most likely to impact our ability to extend homeownership to non-traditional homebuyers, and yet the field remains an unregulated, sales driven enterprise.

As the lenders at our roundtable attest, the great difference between homebuyers the market has traditionally felt comfortable with, and the low and moderate income first time buyers that new homeownership initiatives are trying to reach, is not so much income as the ability to master credit: to understand how much their credit is costing them, and to learn to use it without spreading themselves too thin. Meanwhile, the new breed of homebuyer can make easy prey to sub-prime lenders and insurers, a group who have also seen opportunity in the national priority on homeownership.

While there are organizations that accredit homebuyer councilors, there is nothing requiring anyone to seek those councilors out. In a sense, the closest thing to regulation of homebuyer education might be Fannie Mae's requirement that certain loans be accompanied by certification that the buyer has completed a course of homebuyer training. But there are no standards as to what that course entails: some buyers have attended a 13 week course; some have merely answered a few questions over the phone. Meanwhile, those who extend sub-prime loans - to the very people whose credit issues cry out for counseling - face no requirements to include homebuyer education at all.

The need for standardization in homebuyer education is widely recognized. To address it, Fannie Mae has initiated the American Homeowner Education and Counseling Institute with 29 non profit and for profit partners. The Institute's goal is to establish national standards for homebuyer education and for counselor training. Fannie Mae alone has made a $2 million endowment to the project, but after doing so, Fannie Mae and the Institute have taken pains to decentralize the process and limit their role to that of facilitator.

Currently, the Institute is supporting local collaboratives in cities

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as it can be. And it's not just people saying 'We're willing to think about it.' You've got programs that are built in with some very relaxed parameters."

If anything, the group thought we might see things roll back a little bit, as default rates begin to mount.

Leony confesses she is sometimes a little alarmed by the flexibility she's seen herself. "I think it's because we all have very good intentions, and wanted to help out, but anytime you stretch a guideline, you open it up to abuse."

"What you have is back end ratio creep," Calvin says. Lenders have been more willing to accept applicants with higher credit ratios - their debt consuming a larger percent of their income and putting greater strain on their ability to keep up with their mortgage. "But there's talk from a higher level of the credit policy committee. They say 'Wait a minute. We have to stop at some point."

It takes a few years for loans made under relaxed guidelines to prove whether they will fail or flourish. But now, "there's finally a history you can look at." Carl says. "And we're seeing default rates rise."

No one wants to make bad loans that will just be a disservice to the borrowers and the community. "It's one thing to put a family in a home. It's another thing for them to maintain that," Leony says. "Educational assistance is key, prior to purchase and after the loan closes."

"What obstacles do first-time and low and moderate income families face?"

Keeping families in their houses, and keeping the bank's real estate holdings to a minimum, depends on understanding the challenges facing homebuyers. One of the main challenges to homebuyers of all categories is the national tendency to spread our resources too thin.

Kein Burton paints a picture the whole group can recognize. "You have a construction loan, and you counsel people. You tell them they are already marginal on this loan." Their credit ratios are high, and they may be complicated by other factors. "You tell them 'We still think we can make this loan. But one thing you cannot do" - and the whole group joins in — "is borrow any more money."

"And they nod, and they say, 'Oh no, this is all I want in my life.'"

But by the time the loan is moving toward closing, things have changed. "You see they've been spending some time buying furniture. And they've bought a new car. And it's a really nice one."

Kein describes it as a lack of sophistication. "I honestly don't think people understand the power of money."

The group agrees the phenomenon is not limited to low income buyers.

"It happens with the wealthy as well as the poor," Calvin stresses. "And what they will say is 'But I've made payments like this before.' Because there are a lot of people who are just accustomed to stretching themselves very thin."

It's the American Dream in action, as Leony describes it — "People want to belong; people want to be a part of the mainstream" — and it extends beyond housing. "We all make it easy for you to buy a car, no down payment."

"No sacrifice," Calvin says.

The problem cuts across class boundaries, but it is a bigger problem for families whose claim to the middle class is less entrenched. "In many cases, you're looking at the first generation of real professionals," Kein says. "They really do have a nice income. And they compare themselves up against their majority counterparts." The majority counterparts have a lot of nice things; they also have the security of second and third generation wealth. "They have a safety net. Their parents have money. Their grandparents have money."

The lack of a safety net poses an even greater threat to the mortgage of low and moderate income buyers. "We're talking about people who are marginal anyway," even without high credit ratios. "They're in marginal jobs, in marginal wages. One thing goes wrong - their car breaks down, they can't get to work. They are the most likely people to just lose their job because their child gets sick. You have whole layers of circumstances that surround low and moderate income people. It's a domino effect."

Kein sees these issues as broader socio-economic problems that banks are called to answer for. "It's a cliche, but our economy is a service motivated economy, and I see people with very, very low wages, with very little ability to amass any type of wealth. They don't have pensions, they don't have 401K plans. A lot of the discussion centers around what bankers can do, but there are some issues here that banking has nothing to do with. We as lenders cannot change the way our society does not pay a living wage."

"What do you think ought to be done to address these obstacles?"

The challenges seem to be pretty clear. "Credit and jobs," as Kein says. How then are we to address them? The group varied on specifics, but everyone agreed each application must be carefully evaluated on an individual basis.

Should families whose low wages make it impossible for them to amass wealth be given down payment assistance?

Estella says yes. "You see a long history of an individual, living in an apartment, paying $800 a month in rent, and for a dump, mind you. And they're paying the rent on time every month.

Calvin is not so sure. "I don't mind closing cost assistance. But I've seen people who could not come up with $1000 down. If you can't save for that, what makes you feel secure that you're going to be able to pay your mortgage if your mortgage is like six or seven hundred dollars a month?"

Kein says "I agree with both of you. I think there are also circumstances where people should not be in a homeownership situation. I've also seen couples who are in their forties who are doing quite well who don't overuse credit, but they don't ever get there. And they're paying a lot of money in rent. I think those people could use downpayment assistance."

"It's very hard for people to say 'I'm absolutely against this,' or 'I'm absolutely for this.' Everyone's circumstances are different."

Is credit scoring going to change the way banks make loans? Emerging quickly over the past 6 months, credit scoring promises to give lenders a standardized assessment of an applicant's credit situation. Today, a handful of companies calculate the credit score of an applicant to help the lender evaluate his or her application. But how do you use it?

"Some shops rely solely on the credit score. Even the credit scoring people tell you it should not be the sole determining factor," says Carl.

Leony says "But it will be hard to overlook when someone comes in with really low scores. It's important that the decision is based on the totality of the loan file."

Carl says "But that's the point. What's a low score?" The group could not agree.

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The Federal Reserve and the Mortgage Credit Access Partnership

In 1996, the Chicago Fed initiated a partnership with representatives from more than 100 organizations from small nonprofit agencies to large lending institutions to identify practices that might foster disparate treatment or outcomes in the home-buying process. For the past year, this Mortgage Credit Access Partnership (MCAP) has worked to identify, prioritize and recommend solutions to address unfair housing and lending practices.

The group identified four key areas to examine: the home appraisal process, credit rating, professional and consumer education, and Federal Housing Administration (FHA) issues. Four task forces were established to delve into these areas further. On May 29, the partners assembled at the Union League Club of Chicago to discuss the draft recommendations developed by the task forces. "Some of the individual ideas may challenge current thinking on how to do business," commented Chicago Fed President Michael Moskow at the presentation. "Some of the recommendations could result in new challenges and potentially some costs. However, these costs should be balanced by the cost of leaving some residents without a full opportunity to build wealth through home ownership."

Chicago Fed Analyst Mike Berry has coordinated the MCAP initiative with the help of his colleagues in Consumer and Community Affairs (CCA). "Disparities in the home-buying process take myriad forms," says Berry. "It can be unfair loan pricing, steering minorities to specific neighborhoods or policies that unwittingly favor majority buyers. Our goal was to identify and understand the key issues and make informed recommendations to address them."

The Appraisal Process Task Group suggested that all real estate appraisers be licensed and certified. This would serve as a means to ensure that appraisers have undergone fair housing and fair lending training, and as a way to censure appraisers who use unfair practices. At the same time, the Professional and Consumer Education Task Group's recommendations called for the

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across the country. These local collaboratives will generate their own standards and recommendations. The National Institute will draw on their conclusions to assemble nation-wide guidelines. In Chicago, this initiative has brought homebuyer counselors and trainers together with lenders - including both prime market lenders and private mortgage companies - community organizations, the Department of Housing and IHDA. They have been meeting since March as the Greater Chicago Homeowner Education and Counseling Collaborative.

The Chicago Collaborative's Standards Committee has already assembled a standard curriculum. 'That was the easy part," explains Greg Smith, who is CRN's homebuyer counselor and who co-chairs the Greater Chicago Collaborative with Citibank's George Wright, "because homebuyer education is what we all do." In upcoming months other committees will take on other tasks.

For instance, the Cost Benefits Analysis Committee will work on strategies to measure the impact of education and counseling. "We assume there is a connection between education and long term success of the mortgage, but we don't know," Greg explains. To some extent, the committee recognizes the connection cannot be measured perfectly. Most defaults are the result of a life change - a death in the family, the loss of a job. No one can anticipate that. On the other hand, the committee does expect to establish that education results in a reduction in rates of denied applications, since the education process helps educators ensure that an applicant's affairs are in order before the application goes in.

The Fundraising Committee is raising money to support the collaborative, and, more importantly, to investigate means to fund homebuyer counseling in general. Currently, homebuyer education is sales driven: lenders are motivated to pay for it to the extent that the secondary market requires it be a part of the mortgages they buy, or to the extent that it helps them close more loans. Any aspect of homebuyer education that does not directly impact a lender's ability to close a loan, or to turn around and sell it to Fannie Mae, is difficult to pay for. For instance, many lenders acknowledge

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"I think the jury is still out on credit scoring," Calvin says. He and Carl sat on a task force held by the Federal Reserve where credit scoring was discussed. "Our biggest argument is 'How can we use credit scoring when we know there are issues with how the credit score is derived, and what goes into it?'"

"What do you think about community development corporation homeownership programs?"

The one thing everyone agrees all first-time and low to moderate income homebuyers need is thorough homebuyer education.

"Counseling programs," says Leony, "That's another thing that we need to talk about. What counseling programs?"

Homebuyer counseling needs to be more thorough. "There's just a wide range of counseling out there." Carl calls it the good, the bad, and the non-existent. "Sign a certificate and they've completed the course. That's non-existent."

When counselors don't do their job, the loan officer can find herself doing catch up counseling to make a loan work, the group explains. "Loan officers are sales people. They're commission people. They're not counselors."

Homebuyer education needs to begin earlier in the process. "You get first time homebuyer programs where it's getting close to closing, and it's 'Oh! You need a certificate,'" Carl says. "The ideal counseling for a first time homebuyer begins before they even look for a property: what to look for in a home, what to expect in the real estate contract, home inspections..."

And maybe it ought to begin even sooner than that. "We send out credit card applications to new college students," Carl points out. They can start ruining their credit before they even understand what it is. "I think a good start would be to have classes in money and finance in high school."

"Whose job is that?" asks Kein.

"I guess that's part of CRA," says Leony. First National's Community Outreach and Education Division visits grammar schools. Other banks open branches in high schools.

Post-purchase counseling is also essential. Calvin can only think of a couple of community organizations that do it effectively. Those groups recognize that their ability to get more people into homes depends on the success of the mortgages they have already brought to the lender. "So they're staying on Mr. and Mrs. Doe to keep the payments up. If a 30 day late flag goes up, they go in and say 'Look, above all else, pay the mortgage.'"

Other community developers are exploring more affordable home ownership options.

"There's nothing wrong with co-ops and condominiums," says Calvin.

They can be more affordable than detached housing. "You put a family in a four bedroom, extremely spacious condo," says Kein "at $40 to 45,000, and they own it. I'd love to see more of that kind of thing going on."

And condos can be made more affordable without compromising construction quality. "There's a lot of cheap stuff that goes into a detached house that's going to top out at $80,000," Kein adds. "I really worry about the quality."

"Co-ops and condominiums were designed as transitions," Calvin says. They can help a family learn what goes into owning a house before they find themselves alone in one. "There are some people who still need to be able to call Mr. Smith and say 'My sink leaks. Can you come fix this?'"

Meanwhile, lenders continue to feel pressure to lend more money in disinvested communities. "There will always be a strong commitment to increase lending in low/mod areas," Leony says. "Statistics show that these areas continue to be underserved." While a crop of affordable loans have sprung up in the past year or so, Leony believes lenders must strive for balance as they develop mortgage programs with flexible underwriting, high ratios and low downpayments. "We don't want it to become a disservice to communities that we are trying to revitalize."

To some extent, lenders have responded by finding new ways to meet old goals. Kein says "CRA has become easier to pass then ever before." Lenders have been making more loans in disinvested areas, but a lot of them are going to upper income people moving back in. "That's what CRA has become," Kein says. Lenders can circumvent requirements to make loans to low and moderate income individuals by refinancing homes of people who have lived there for a long time. The property value has gone up, but the family is still low to moderate income. "There are a lot of tricks to passing a CRA exam these days."

These new loans highlight new challenges.

"Now you have communities going through gentrification," Calvin says. "As lenders, we have not really been forced to take sides on this issue."

"You need an injection of funding and new money into the community to revitalize it." Leony says.

"This whole idea is supposed to be about healthy and vibrant communities," Kein says "On the one hand, we don't want to be advocates of displacement. On the other hand, long term, viable community development cannot rest solely on low and moderate income individuals."

"I would say that's one of the biggest shifts that we've seen, and that's going to be the next argument," Calvin says. As redevelopment brings people back, people who have been living there for years are going to begin to ask new questions. " 'Gee, I was shut out,' now you guys are falling all over yourselves to lend money."

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the importance of post purchase counseling. Post purchase counseling can prevent a new homebuyer from being overwhelmed by repair bills by teaching basic maintenance and home repair; it can prevent a missed mortgage payment from spiraling into foreclosure; it can even help prevent a homebuyer faced with a foreclosure notice from simply abandoning the property. Lenders recognize these functions, but that does not mean they will pay for it.

The lender driven system can also encourage creaming: the skimming of the best candidates, many of whom could have qualified for loans without assistance, as the education provider concentrates on bringing loans to close with a minimum of work. "Lenders will offer to pay for homebuyer education, but it will come to about $200 for a closed loan," explains Greg, who is also CRN's Homebuyer Counselor. "That doesn't even begin to cover the investment." The real work of reaching a larger segment of Americans and preparing them to be homebuyers is long term work.

Many of the candidates, if we are talking about candidates who would not be homeowners otherwise, will start out far from the goal, just trying to get a handle on their credit, and they may never be quite ready to be a homebuyer. Traditionally, these candidates have been left to community organizations who see their work as a long term investment in the community, not as a means to meet loan quotas. Community organizations are more willing to take on the kind of homebuyer education that begins with someone whose credit is in outer space, because they will improve the situation of that member of the community, even if they don't ultimately close a loan.

The standardization of homebuyer counseling is an overdue effort. At the same time, it is important to ensure that the professionalization of the homebuyer education industry does not mean that it becomes the province of bank trained professionals, who cream the best clients with an eye toward payoff on their investment. We must maintain the community development vision of education as a long term investment in the community.

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licensing and certification of industry professionals and the introduction of fair lending and fair housing language into training curriculums. It also plans to publish a consumer guide to fair housing and lending laws.

The Credit Rating Task Group called for more efficient resolution of credit report disputes between creditors and borrowers. "When first-time, low-income borrowers or those with a language barrier apply for a mortgage and there's inaccurate information on their credit report, they often become frustrated and drop out of the application process, because it typically takes 30 days to resolve a credit report error,"explains Berry. "The group found that some firms consistently report out-of-date information." The credit group recommended better monitoring of credit reporting firms and the use of a universally accepted credit dispute form that would accelerate the dispute process.

The FHA Issues Task Group focused on quality control in loan origination and servicing. Its main concern was to address the high concentration of foreclosures in specific communities by establishing "place-based" strategies that target neighborhoods with high turnover and vacancy rates. The group also called for standardized, accredited counseling of first-time home buyers.

The final recommendations are scheduled to come out in September. "A lot of people have devoted time to this initiative," comments Berry. "Alicia Williams, our vice president, was part of a group of System Community Affairs officers that developed an initial framework for the process. She serves on the steering committee, as does [Senior Vice President] Nancy Goodman, and attends all of the FHA task group meetings. John Fazio joined CCA last year and has been instrumental to the program's success. We've been able to develop some invaluable relationships across many industries."

"We're in a position to implement some real change," said Moskow. "As much as we can, we want to ensure fair and consistent treatment for all home buyers, regardless of where they choose to live, or their race, ethnicity or gender."

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