Financing the American Dream

Best Practices in Affordable Homeownership Lending

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
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Homeownership is the American Dream. Owning a home is the largest single asset that most families ever own. Homeownership is the main source of wealth for many of our nation's households. Yet to attain that ownership, people need to borrow substantial amounts of money from private mortgage lenders. The ability to save for a small downpayment and borrow the funds to be repaid with modest monthly payments is the heart of the American way of homeownership financing.

Beginning in the 1930s, a public-private partnership created the system of mortgage insurance and guarantees pioneered by the FHA and the VA, and the system of mortgage market support through such institutions as the Federal Home Loan Banks, Ginnie Mae, Fannie Mae, and Freddie Mac. Since 1934, the FHA alone has enabled more than 23 million families to own their own home through affordable financing.

President Clinton's National Homeownership Strategy has generated a new nationwide public-private partnership designed to reduce the costs and simplify the process of buying and owning a home. Private mortgage lenders are playing a major role in organizing the National Partners in Homeownership and the many local partnerships that have helped create 4.4 million new homeowners in the past three years.

The recent dramatic rise in homeownership -- the largest increase in three decades -- is strongly linked to an expansion of affordable home mortgage financing. First-time homebuyers, low- and moderate-income families, women and minority homebuyers, young adults and families, new immigrants from across the globe, urban homebuyers: all are more able to obtain an affordable home mortgage and attain the American Dream. The "best practices" explained in this booklet and the case study examples show how and why the goal of expanding homeownership is now being achieved.

All of us have much more work to ensure that everyone has the opportunity to attain the American Dream of owning their own home. Every day, we are making substantial progress, and the partnerships of lenders, investors, insurers, and other active participants in the home financing system are opening more doors to affordable homeownership. Let us continue working together toward this important goal for our nation.

Henry Cisneros

SUCCESSFUL AFFORDABLE HOMEOWNERSHIP LENDING

Affordable homeownership initiatives are a critical component of the President's strategy to increase America's homeownership rate to an all-time high of 67.5 percent -- with the addition of 8 million new homeowners by the end of the year 2000.

Responding to President Clinton's challenge, the National Partners in Homeownership, a nationwide public-private partnership of 58 organizations, including the U.S. Department of Housing and Urban Development (HUD), is working to bring the benefits of owning a home to more Americans and their communities. Homebuyers benefit from the savings and equity of ownership, help stabilize their communities, and strengthen the nation's economic growth.

Women, low- and moderate-income families, minority and legal immigrant families, young adults and urban families, represent an untapped, and largely underserved, market, and the main targets for expanding homeownership. Many of these potential first-time homebuyers either do not believe they can own their own homes, or do not have access to the mortgage credit needed to buy a home and a stake in their communities.

Following enactment of the Community Reinvestment Act and the Federal Housing Enterprise Financial Safety and Soundness Act, many in the home mortgage lending industry have developed affordable homeownership loan programs that reach out to underserved families and communities, as Congress intended. As these programs were introduced, the home mortgage industry created management practices to better manage its performance.

This report identifies the "best practices" being employed by home mortgage lenders and secondary mortgage market institutions to develop and manage affordable homeownership financing programs.

WHAT IS AFFORDABLE HOMEOWNERSHIP?

"Affordable homeownership" is a generic term used for a wide variety of purposes within the housing and mortgage lending industries. Different statutory definitions exist within various programs, housing finance agencies define programs to meet their individual needs, and private providers of mortgage credit have developed their own definitions as well.

To provide an appropriate context for considering the best practices identified in this report, the following broad definitions have been developed:

- **Non-traditional Loan Programs** - These are loans to borrowers with incomes at or below the median income in the metropolitan area. These programs involve more flexible home mortgage underwriting guidelines, such as loan-to-value ratios greater than 95 percent, non-traditional evaluation of credit, waiver of reserve requirements at time of closing, and liberal debt-to-income ratios.

- **Targeted Loan Programs** - These are traditional loans made under programs targeted at meeting the homeownership needs of low-and moderate-income borrowers and those in geographically underserved areas. Such loans may include state housing finance agency mortgage revenue bonds, mortgage credit certificates, and other programs targeted at first-time homebuyers with incomes somewhat higher than the median income of the metropolitan area.

- **Traditional Loan Programs** - These are loans falling within conventional underwriting guidelines made to low- and moderate-income borrowers.

AFFORDABLE HOMEOWNERSHIP LENDING MAKES SENSE

First-time homebuyers are the driving force behind the tremendous expansion of homeownership in the past three years. Studies show that the market share of first-time homebuyers grew from about 40 percent of all home sales in the 1980s to 47 percent in 1994-95.

The homeownership market is expanding to include households that historically have not previously become homeowners, partly due to economic or ethnic barriers. These include African-American and Hispanic minorities, immigrant families, unmarried individuals, single-parent households, and low-to-moderate income families.

Affordable homeownership loan programs make sense. They serve an otherwise unmet need, deliver homeownership opportunities to underserved families and communities, and open up profitable new business for the housing and mortgage finance industries.

At the same time, affordable housing loans possess certain characteristics that are riskier than traditional mortgage loan portfolios. Some lenders have expressed concern about the performance of affordable housing loan portfolios. Others, especially community-based lenders that have long worked with non-traditional borrowers, claim their methods produce loan portfolios that perform as well as, or better than, traditional lending. While it is still too early to establish definitive trends over time, it is important to understand the differences between affordable homeownership lending and more traditional mortgage loan practices.

Affordable homeownership lending has its special challenges. Large downpayments are generally acknowledged to be the biggest impediment to homeownership. Providing homeownership opportunities to borrowers with limited cash resources requires an appreciation and understanding of their particular circumstances. It is to no one's advantage to sell homes to families that are not able to financially sustain their ownership.

The challenge to home mortgage lenders is to understand and work with the target market segment: offering products that meet their needs while mitigating risks and implementing appropriate management techniques. This will result in safe and profitable mortgage portfolios for lenders and economic stability for homeowners.

To better understand the issues related to affordable homeownership lending, HUD co-sponsored a series of forums and performed informal research and evaluation. These efforts resulted in identifying the following "best practices":

1. Partnering
2. Flexibility
3. Understanding the Market
4. Homeownership Education
5. Homeownership Counseling
6. Affordable Homeownership Loan Products
7. Prudent Underwriting Criteria
8. Enhanced Servicing
9. Early Intervention
10. Default Mitigation

These "best practices" represent ways in which the lending community can address affordable homeownership finance issues and challenges. In the following sections, practical examples describe in more detail the experience of various mortgage market participants.

HUD hopes these examples will help others in the industry initiate successful affordable homeownership lending practices in their communities.

PARTNERING

Establishing alliances between organizations, both for profit and non-profit, for the purpose of furthering affordable homeownership initiatives.

"Partnering" is the first and single most important step toward implementing successful affordable homeownership lending practices. Successful partnering provides a strong foundation for an affordable homeownership loan program.

Establishing and nurturing partnerships provides the necessary connections between nonprofit and for profit developers, primary and secondary mortgage market lending institutions, mortgage insurers, and local communities. Non-profit service providers and community groups can assist by:

- Identifying potential borrowers;
- Providing knowledge of local homeownership market conditions;
- Providing pre-purchase homeownership education and counseling;
- Identifying market needs and designing affordable homeownership loan products to meet them;
- Assisting with post-purchase follow-up and early intervention when the homebuyers face financial difficulties.

The National Partners in Homeownership is built on these principles. It takes the best of both national and local partners: national partners provide the support and technical assistance, and local partners implement targeted strategies to promote homeownership based on their knowledge of local markets and their extensive outreach networks.

PRACTICAL APPLICATIONS OF PARTNERING:

Neighborhood Assistance Corporation of America (NACA), a community advocacy and homeownership services organization, recently partnered with NationsBank to provide $500 million for a five-year, no-downpayment, no-closing-cost, liberal-underwriting mortgage program in six East Coast cities and Texas. It also has agreements with Fleet Bank, BankBoston, Barnett Bank, First Union, Riggs Bank and Mellon Bank to fund this affordable homeownership lending program with total commitments exceeding $1 billion.

- NACA's role is to provide homeownership education, real estate brokerage, one-on-one homebuyer counseling, assistance with loan processing, a post-purchase counseling program and foreclosure mitigation efforts. NACA also maintains a Neighborhood Stabilization Fund to prevent defaults by making up to three months of mortgage loan payments to eligible homeowners during periods of financial hardship.

Neighborhood Reinvestment Corporation and its National NeighborWorks Network promote affordable homeownership through local partnerships in 180 cities, towns and rural communities. In addition, its national secondary home loan market, Neighborhood Housing Services of America (NHSA), partners with numerous investors to replenish the NeighborWorks organizations' revolving loan funds and help leverage local private sector resources.

- For example, the Boise, Idaho, Neighborhood Housing Services developed a $2.3 million loan pool with six private lenders to offer no downpayment home purchase loans without mortgage insurance to targeted lower-income homebuyers. The six banks purchase these loans and hold them in their portfolios. Thus far, there have been no delinquencies on 100 of these high-leverage mortgage loans.

PMI Mortgage Insurance Co., World Savings of Oakland, California, and Neighborhood Housing Services of America (NHSA) created a "risk-sharing" partnership to provide low-downpayment homeownership loans to targeted urban and minority borrowers. They use a layered co-insurance agreement to share the risk for paying claims on defaults of home mortgage loans with downpayments as low as 2 percent.

- Sixty lenders in 31 states are expected to participate in the third phase of this PMI/NHSA program that has exceeded $50 million in low- and moderate-income homeownership mortgage loans in the first five years, and is soon expected to reach $100 million.

FLEXIBILTY

This is a vital approach to affordable homeownership lending that focuses on how to meet the needs of non-traditional and underserved borrowers and communities.

Flexibility is a key practice that is integral to the overall success of any affordable homeownership loan program. It is essential for developing new mortgage loan products and judging the creditworthiness of households in underserved markets, and for implementing effective portfolio management and loss mitigation practices.

Flexibility means doing away with hard and fast rules and considering whether a different approach would achieve the same objectives. The purpose is not to loosen standards but to adopt guidelines that appropriately consider the unique circumstance of low- and moderate-income homebuyers and underserved markets without materially increasing a lender's exposure to loss.

PRACTICAL APPLICATIONS OF FLEXIBILITY:

Mortgage Guaranty Insurance Corporation (MGIC), in partnership with Fannie Mae, Zion Mortgage of Salt Lake City and the Navajo Nation, developed a homeownership loan program for residents of the Navajo reservation. The loan program has unusual features due to the unique needs of the Navajo Nation:

- Construction cost, rather than resale value, is used to determine the appraised value of homes because it is difficult to obtain comparable home sales prices on the reservation.
- Another feature of the program is that the borrowers' neighbors, represented by the tribal organization, may take responsibility and help determine how to avoid and manage potential delinquencies and defaults.

Guaranty Bank of Milwaukee, Wisconsin, found that it is important to demonstrate the management's commitment to affordable homeownership principles.

- The bank appointed a senior officer as an internal advocate who has authority to develop and implement meaningful affordable homeownership programs that meet the needs of underserved borrowers and communities.

The Federal Home Loan Bank Homeownership Set Aside program involves six of the twelve Federal Home Loan Banks (FHLBanks). This group of FHLBanks have set aside a total of $6.5 million per year for homeownership out of their $100 million annual Affordable Housing Program (AHP). These highly flexible AHP funds are used in conjunction with a wide variety of public and private sources to develop affordable homeownership financing initiatives by local private lenders and community groups.

UNDERSTANDING THE MARKET

Another overriding principle to affordable homeownership lending, determining what the borrower needs and developing products to meet these needs.

Understanding the characteristics of an underserved neighborhood or group of people is particularly important when designing affordable homeownership loan products.

Lenders must be careful not to generalize too broadly about the needs of low-income and minority homebuyers. Many ethnic groups, for instance, utilize non-traditional savings patterns while others may be uncomfortable with the concept of borrowing for an extended period of years. Still other groups have a tradition of renting homes and are unfamiliar with the experience of homeownership.

Local homeownership organizations, such as religious institutions and advocacy groups, can provide invaluable assistance to mortgage lenders by helping to determine the affordable homeownership financing needs and borrowing practices within minority groups and immigrant communities.

In addition to the traditional single-family unit, various types of homebuying opportunities are available for affordable homeownership. For example:

- Manufactured homes can be a viable affordable homeownership source for many low-income first-time homebuyers.
- "Granny flats," or add-on apartments built for older relatives, can be converted to additional rental housing or homeownership in older neighborhoods where two- to four-family homes exist.
- Home renovation loans are very important in older urban areas.
- Loans on cooperative homeownership shares are important, particularly in New York City.

PRACTICAL APPLICATIONS OF UNDERSTANDING THE MARKET:

Chase Manhattan Bank emphasized the importance of having staff members who understand the community where affordable homeownership is the focus.

- First-time homebuyers tend to rely on friends in church groups, on community organizations, and on their relatives as sources for market information. Their mortgage lending officers must not only participate in these organizations' activities, but also have mortgage loan products that meet the needs of home loan borrowers in these communities.

American Savings Bank of Stockton, California, knows the importance of understanding its East Los Angeles market. Potential homebuyers frequently hold two or more jobs and often are paid only in cash. American Savings Bank often counts this cash income in underwriting a home mortgage loan, even when it cannot get written income verification from the employers.

- These homeownership loans are adjustable rate mortgages with loan-to-value ratios of 95 percent. American Savings Bank holds the affordable home mortgage loans in portfolio and has experienced very few defaults.

Guaranty Bank of Milwaukee, Wisconsin, launched an affordable home mortgage lending campaign to reintroduce the Bank to potential inner city homebuyers. In cooperation with nonprofit organizations, Guaranty Bank conducted homeownership seminars. It also established full-service banks in locations convenient to inner-city residents, such as in food stores to provide checking and other financial services, in addition to home mortgage loans.

- Guaranty Bank recruited a full-time loan officer and set up a full-service outlet in a conveniently located shopping mall to better meet the needs of inner-city residents for home mortgage loans and other banking services.

- Guaranty Bank's Office of Community Relations works closely with non-profit groups to promote homeownership in 121 census tracts in Milwaukee's inner-city neighborhoods These groups include the Fair Lending Coalition and the Milwaukee Inner City Congregation Allied for Home.

HOMEOWNERSHIP EDUCATION

Providing classroom education to potential homebuyers about the responsibilities and opportunities of homeownership.

Affordable homeownership loans mostly go to first-time homebuyers. Many low-income families and minorities have little previous experience with homeownership. They often have limited personal financial and budgeting capacity, and do not appreciate the tax and asset benefits of owning a home.

Homebuying fairs, church-sponsored clubs, and other community outreach programs are frequently the first time homeownership concepts are presented to low- and moderate-income and minority and immigrant homebuyers.

Once potential homeowners are identified through these outreach efforts, they generally participate in some type of homeownership counseling and education program that meets their particular circumstances and helps them to pre-qualify for home mortgage loans.

While the timing, length and substance of homeownership counseling and education provided will depend on the circumstances of the individual and family, there are some key elements generally included in most programs. Homeownership education and counseling are part of a two-step process that assists potential homebuyers in developing and executing a financial plan to purchase a home and provides the necessary tools to be successful homeowners.

Homeownership education tends to be classroom-based and focuses on the mechanics of homebuying -- understanding what a mortgage is, how much home one can afford, how to work with a Realtor, what to look for when selecting a house, how to make an offer on a house, how to obtain and evaluate a home inspection, the home sale closing process and its costs, and the responsibilities and financial demands of acquiring, maintaining, and repairing a home.

Ideally, homeownership education is provided before a potential homebuyer begins to look for a house and definitely before a sales contract is executed. It is usually followed by homeownership counseling which is covered in the next practice.

It is generally agreed that homeownership education and counseling programs contribute to the success of affordable home mortgage lending. In fact, the home finance industry is contributing significant financial resources to this effort by jointly creating the American Homeowner Education and Counseling Institute.

- With \$4.9 million contributed by 29 organizations, including a substantial grant from the Fannie Mae Foundation, the Institute will develop models and a curriculum for training and certifying homeownership educators and counselors. HUD, along with many other mortgage industry participants, is providing financial support for the Institute.

PRACTICAL APPLICATIONS OF HOMEOWNERSHIP EDUCATION:

Chattanooga Neighborhood Enterprise (CNE) provides a fast-track course in homeownership for low-income families who are willing and able to buy a house in Chattanooga.

- The course, which includes a training manual and a test based on the manual, was adopted by the Neighborhood Reinvestment Corporation and is being used for training low-income borrowers by the National NeighborWorks Network, in the Cherokee Nation, and in Pine Bluff, Arkansas.

- Homeownership education involves more that just financial management skills. Chattanooga Neighborhood Enterprise also conducts a "Life Skills" program that includes training in the basics of homebuying credit and banking requirements, as well as nutrition, personal development, home maintenance, auto maintenance and effective parenting. The training is primarily for people coming out of publicly-assisted housing.

GE Capital Mortgage Insurance Corporation has an in-house Homebuyer Education Center which, utilizing both English and Spanish-speaking counselors, has counseled over 20,000 potential homebuyers.

- GE mails a Study Guide to persons who are applying for a home mortgage loan. The applicant then telephones the Education Center and is interviewed to determine if he or she has read and understands the Study Guide materials. The applicant must successfully complete the phone interview before GE will insure the home mortgage.

- GE strongly encourages private lenders to have the Study Guide used by potential homebuyers before a contract is signed for the home purchase.

Atlanta Mortgage Consortium provides an eight-hour homeownership education program which has significantly reduced problems and mortgage loan delinquencies in its $98 million below-market-rate affordable financing program for low- and moderate-income homebuyers.

HOMEOWNERSHIP COUNSELING

Offering one-on-one counseling sessions between potential homeowners and a counselor to assess the homebuyer's financial situation and advise on homeownership opportunities based on the unique circumstances of the mortgage borrower.

Once potential homebuyers have completed homeownership education and are interested in purchasing a home, homeownership counseling is appropriate. Most potential home mortgage borrowers need this information and guidance before they are ready to actually purchase a home.

Understanding a borrower's financial circumstances and credit history is the cornerstone of homeownership counseling. Homebuyers need to evaluate their own financial and credit situation as well as understand the financial implications of obtaining and maintaining a home mortgage loan.

Homeownership counseling is provided through one-on-one sessions between the potential homebuyer and a counselor, working together to develop financial goals and a strategy for achieving them, including budgeting and savings plans. Counseling entails a very close look at each homebuyer's financial position, and the counselors include an honest evaluation of the borrower's ability to manage mortgage debt.

When a prospective homebuyer has developed a viable financial plan, homeownership counselors are generally available to advise on the more immediate and practical aspects of finding and purchasing a home.

Homeownership counseling is usually viewed as a long-term process, taking as long as 18 months to complete before a home purchase is made. Homeownership counseling often continues, and should be continued, after the home purchase is completed.

PRACTICAL APPLICATIONS OF HOMEOWNERSHIP COUNSELING:

The Center for Community Self Help in North Carolina attracts potential homebuyers through outreach efforts with community organizations and real estate professionals. Homeownership counseling begins with extensive help on budgeting.

- Budget counseling is an important component of homeownership because homebuyers often have "payment shock" when home mortgage costs exceed rental costs. Homeownership also causes additional maintenance costs that long-time renters may not be prepared for.

DuPage Homeownership Center, a non-profit homeownership counseling agency in Wheaton, Illinois, offers a First-Time Buyer Certification Program. The center coordinates the DuPage Homestead Program for first-time homebuyers earning less than 80 percent of the county-wide median income, and the Home-Stretch Program for families earning between 80 and 100 percent of the county's median income. Participating homebuyers must complete the homeownership education and counseling program.

- The DuPage program begins with group sessions that discuss the pros and cons of homebuying and the importance of budgeting and sound financial management. The sessions also include the basics of home mortgage borrowing and the importance of mortgage pre-qualification or lender pre-approval before shopping for a home.

- The DuPage program continues with individual homeownership counseling. Counselors meet with clients to review their credit histories and develop a Homeownership Action Plan. The plan includes monitoring their progress.

- When prospective homebuyers know what they can afford, they receive counseling on selecting homes, entering sales contracts, evaluating home inspections, and maintaining homes.

Acorn Housing, a national non-profit homeownership counseling organization, operates a program in 23 cities that provides individual financial and homeownership counseling. This program emphasizes face-to-face counseling that is tailored specifically to a homebuyer's particular circumstances. Face-to-face counseling allows a homebuyer to establish a relationship with a counselor, resulting in a more realistic assessment of the mortgage borrower's situation.

AFFORDABLE HOMEOWNERSHIP LOAN PRODUCTS

Offering home mortgage loan products that are designed to meet the unique needs of first-time homebuyers and low- and moderate-income borrowers.

The home mortgage lending industry has developed a wide variety of loan products to address the needs of underserved families and communities. Lenders entering the affordable homeownership business may benefit by adapting these loan products to the needs of potential clients.

Affordable homeownership loan products usually are designed to address the needs of low- and moderate-income households who have satisfactory and stable monthly incomes. These potential homebuyers may lack traditional credit and employment histories and savings for downpayments.

Many affordable homeownership loan products include high loan-to-value ratios -- 95 percent or more -- to accommodate low downpayments. They often include higher debt-to-income ratios, recognizing that low- and moderate-income families frequently devote as much income to rent as they would to making mortgage loan payments. Other characteristics of affordable homeownership lending include flexibility in reserve requirements, consideration of employment history and credit standards.

PRACTICAL APPLICATIONS OF AFFORDABLE HOMEOWNERSHIP LOAN PRODUCTS:

The Federal Housing Administration (FHA) provides housing opportunities for low- and moderate-income families and has successfully pioneered many of the affordable homeownership loan products that now are being used by the private market.

- FHA insures a wide variety of affordable home mortgage products, ranging from the basic single-family home loan program with a 3 percent minimum downpayment, Section 203(b), to its 97 percent loan-to-value loans for rural areas, Section 203(i), and its special combined home purchase and renovation loans, Section 203(k). Other FHA loan products include reverse mortgages for the elderly, home loans for neighborhood revitalization, home loans for families displaced due to natural disasters, special risk loans, and loans for cooperative homeownership, condominium homeownership, and manufactured homes.

Freddie Mac and Fannie Mae are leading the way in developing affordable homeownership loan products for the secondary mortgage market. As government-sponsored enterprises subject to HUD oversight, they are required by law to devote a large percentage of their secondary mortgage business to affordable housing.

- Among their many affordable homeownership loan products, Freddie Mac and Fannie Mae both offer 95 percent loan-to-value mortgage loans, including 3/2 mortgages that allow

2 percent of the down payment to come from gifts and grants. Both offer or will offer 97 percent loan-to-value mortgages. They both support flexible credit and debt-to-income requirements, and both have education and counseling re-quirements for affordable homeownership loans.

- Fannie Mae and Freddie Mac also purchase home mortgage loans from a variety of programs that are targeted at underserved borrowers and communities, including rural and Native American homeownership loan programs.

PMI Mortgage Insurance Co. developed a "prudent" low-downpayment, 25-year affordable homeownership loan backed by Fannie Mae for borrowers with incomes up to 115 percent of the metropolitan area's median income. The shorter amortization period -- 25 years, instead of 30 -- reduces risk to PMI and its investors, and provides faster equity buildup for the homebuyers.

- On a $70,000 mortgage, the 25-year amortization would cost the borrower only $20 a month more than a 30-year mortgage, and will save the borrower more than $28,000 in interest. Faster equity buildup means more flexibility for the homeowner to sell or refinance the home.

Atlanta Mortgage Consortium (AMC), comprised of seven banks in the Atlanta area, offers low- and moderate-income families a below-market-rate home mortgage loan with a 3 percent downpayment, which can come from gifts or grants.

- The interest rate is 0.5 below the market rate when the market rate is 10.5 percent or less and 1 percent below market when the market rates are higher. AMC's guidelines for maximum debt obligations are 35 percent on the home loan and 42 percent on total debt. Mortgage loans are processed and serviced by a third party, Standard Mortgage Corporation, while AMC provides outreach and marketing to homebuyers.

Mortgage Guaranty Insurance Corporation (MGIC), in conjunction with the Neighborhood Reinvestment Corporation's National NeighborWorks Network program, agreed to insure mortgages with combined loan-to-value ratios of up to 120 percent, and sometimes higher for homes that need extensive renovation, when home values are expected to increase in neighborhoods because of NeighborWorks' efforts.

- An amount in addition to the first mortgage may be in the form of a traditional second mortgage, a mortgage with partial payments deferred, or a "soft" second where loan repayment may be postponed or cancelled under certain conditions. A loan that permits rehabilitation of the home is frequently needed in underserved areas.

PRUDENT UNDERWRITING CRITERIA

Judiciously applying non-traditional underwriting criteria and carefully considering compensating factors to ensure that a sound loan is made.

To establish affordable homeownership finance as a core business strategy for the mortgage lending industry, it must be profitable.

While flexible loan products are an essential part of affordable homeownership lending, care must be taken to avoid increasing risks to unacceptable levels. The best advice is to manage the layering of risks and to ensure that there are adequate compensating factors to balance adjustments made in the underwriting process.

The performance of affordable homeownership loan programs for low-and moderate-income families and underserved communities must be monitored to ensure that it is achieving the goal of improving homeownership opportunities without creating financial burdens for lenders or homeowners.

Industry studies show that some early affordable loan products resulted in relatively high delinquency and default rates. These products were associated mainly with an excess of "layering risks" -- combining minimal downpayments, waiver of reserve funds, and relaxed debt limits and credit standards.

If affordable home loans simply combine low or no downpayments or closing costs with waivers of the standard requirement of reserve funds to cover mortgage payments for two months, this may leave borrowers with insufficient capacity to meet their mortgage payments if their own monthly income stream is suddenly disrupted.

More recently, many mortgage lenders have constructed programs that carefully weigh each borrower's circumstances and ability to repay the loans. When combined with required homeownership education and counseling, this more balanced aproach can lead to substantional success for lenders and borrowers.

PRACTICAL APPLICATIONS OF PRUDENT UNDERWRITING CRITERIA:

Fannie Mae, Freddie Mac and many mortgage insurance companies have made adjustments to their affordable homeownership loan products to avoid excessive layering of risks, particularly among their high loan-to-value mortgage loans.

North Carolina's Self-Help Credit Union offers a home mortgage loan that requires a 10 percent downpayment. These loans are held by Self Help in its own portfolio.

- Though the downpayment is higher than for most affordable homeownership loans, the mortgage loan has the advantage of more generous credit evaluation. For example, Self-Help will often ignore unpaid medical bills or unpaid credit card charges that are more than five years old.

Guaranty Bank of Milwaukee, Wisconsin, is one of many financial institutions creating better affordable homeownership loans, and rejecting fewer of them because of its careful and extensive review process.

- Any rejected affordable homeownership loan gets a second look by top bank officials, including the chief executive officer, vice president and director of community relations, and chief underwriter.

- With the loan applicant's permission, a third review may be requested by any of five thrifts participating with Guaranty in the affordable homeownership loan program. The application is circulated to the other participating thrifts to determine if any of them have an underwriting plan or loan product that would make the homebuyer's loan possible.

- Rejected home loan applicants are referred to homeownership counseling to prepare them for a mortgage loan in the future.

ENHANCED SERVICING

These are mortgage loan servicing techniques designed to support affordable homeownership borrowers before their loan becomes delinquent.

Affordable homeownership loan portfolios require more attentive servicing and collection techniques to prevent delinquencies.

Generally, servicing a mortgage loan simply includes properly maintaining payment records, collections, and escrow administration. Enhanced servicing must also include special management practices undertaken while loans are still current, to help prevent defaults from occurring.

Default prevention is best achieved by staying in close contact with the new homeowners even after the loan closing, to help them adjust to the process of making monthly mortgage payments. By maintaining regular contact with the homebuyers, lenders more readily identify budgeting and credit issues for the borrowers, and offer assistance to these homeowners before they fall into delinquency.

PRACTICAL APPLICATIONS OF ENHANCED SERVICING:

Countrywide Funding Corporation provides homebuyers an education video at loan closing called "Living the Dream." The video and companion booklet address such issues as using credit wisely, making mortgage payments on time, how to cope with financial difficulties, and how to build up home equity and savings. The homeowners are encouraged to call Countrywide if they can't pay their monthly mortgage, and Countrywide's staff will attempt to resolve the borrower's problems.

Many lenders find that sending reminder notices prior to the 16th day of the month is an effective practice. These notices encourage the borrowers to call and discuss potential impediments to making their monthly mortgage payments, and frequently remind them of homeownership counseling opportunities.

- Fannie Mae requires its loan servicers to send reminder notices on the 10th day of the month for 97 percent loan-to-value home mortgages.

- Norwest Mortgage, Inc., in Des Moines, Iowa, contacts delinquent homeowners on the 10th day after monthly mortgage loan payments are due, before late charges are assessed. Norwest runs its own direct dialing program, calling the affordable homeownership borrower to find out what the problem is and how it can be solved.

- Countrywide mails loan payment reminders on the 10th of the month for all homeowners with 97 percent loan-to-value mortgages. This practice will soon be extended to 95 percent LTV loans, including FHA-insured home mortgage loans.

- Chattanooga Neighborhood Enterprise (CNE) services affordable homeownership loans held in its own portfolio, in addition to mortgage loans CNE has sold to Freddie Mac and Fannie Mae. CNE sends notices on the 10th day after payment is due, stating that late payment charges will be applied if payment is not received immediately. On the 15th day of the month, CNE calls the homeowners, if loan payments have not been received, and offers free homeownership counseling.

EARLY INTERVENTION

These are collection techniques designed to assist an affordable homeownership loan borrower once their home mortgage loan has become delinquent.

Early intervention practices are undertaken once an affordable homeownership loan becomes delinquent. The purpose is to return the loan to non-delinquent status as soon as possible, before it becomes seriously in default.

Once a home mortgage loan becomes delinquent, it is important for the lender to get involved immediately with the homeowner to identify the problems and agree on a proposed solution. The more seriously delinquent a home loan becomes, the harder it is for any borrower to bring it back current, particularly for homeowners with limited cash resources.

Typical collection techniques are not always effective. When affordable homeownership loans become delinquent, active and immediate budget and credit counseling can help the homeowners pay what they owe and return to performing status.

Since, in many cases, the homebuyers are inexperienced, the process of curing delinquencies begins with education and continues through counseling. Homeowners must understand that, if they fall behind on their mortgage payments, early discussions with lenders can keep them out of trouble and help them retain their homes.

PRACTICAL EXAMPLES OF EARLY INTERVENTION:

Chattanooga Neighborhood Enterprise (CNE) is one of several organizations contracted by *GE Capital Mortgage Insurance Corporation* to contact delinquent affordable homeownership mortgage loan borrowers and offer free counseling over the telephone.

- CNE offers tips to homeowners on how to contact the lender directly and what assistance to request. CNE may suggest ways to extend or otherwise modify the home loan that could be acceptable to the lenders. CNE also sends out worksheets and counsels homeowners on establishing practical workable budgets.

DuPage Homeownership Center in Wheaton, Illinois, provides default counseling by working with homeowners in default, bringing them together with their lenders, mortgage insurers, and investors, to develop viable solutions that can help avoid mortgage loan foreclosure.

PMI Mortgage Insurance Co. has an agreement with the National Foundation for Consumer Credit (NFCC) to offer post-purchase counseling to affordable homeownership borrowers with 97 percent LTV loans.

- NFCC provides homeownership counseling through its 1,100 Consumer Credit Counseling Service (CCCS) agencies which contact borrowers directly when they miss scheduled monthly home mortgage payments. The counselors then determine the kind of intervention needed to return the homeowner to non-delinquent status and provide the needed technical and moral support. This support ranges from telephone advice to intensive personal assistance with bud get restructuring.

Mortgage Guaranty Insurance Corporation (MGIC) developed a statistical probability model, the MGIC Loss Mitigation Score, to predict whether a delinquent loan can be cured or will likely go to foreclosure.

- MGIC uses the statistical profile to monitor home mortgage loan servicing activities and, where appropriate, to develop and offer early intervention strategies for homeowners with a higher probability of loan default.

DEFAULT MITIGATION

These are techniques to avoid foreclosure with severely delinquent loans.

Even if severe problems develop with affordable homeownership loans, effective default mitigation techniques can often reduce loss by keeping homeowners in their homes. Foreclosures are costly for the mortgage lending industry and may mean financial ruin for the homeowners, especially for families with marginal incomes.

Loss mitigation makes sense for both the homeowner and the lender, assuming the homeowner has access to sufficient financial resources. No lender wants to take a home away from a family. Further, it is expensive and time-consuming to foreclose on a home. In some states it can take 10 months or more to complete foreclosure proceedings, running up the costs of attorneys' fees, interest charges, insurance, property taxes, and home maintenance.

The mortgage lending industry utilizes many loss mitigation practices to help keep affordable homeownership borrowers in their homes, whenever they default on their mortgage loans. These practices include rainy day funds, repayment plans, forbearance agreements, loan modifications, pre-sales, and deeds in lieu of foreclosure.

PRACTICAL APPLICATIONS OF DEFAULT MITIGATION PRACTICES:

Neighborhood Assistance Corporation of America requires homebuyers to pay into a "Neighborhood Stabilization Fund." Homebuyers contribute $50 a month for five years to the NSF, which is substantially less than they would pay for mortgage insurance.

- If a member of a homeowner family loses his or her job, has a major illness, or another type of emergency, the family can draw on the fund for up to three months of mortgage payments. A NSF committee of homeowners determines whether a distressed homeowner family can tap the Neighborhood Stabilization Fund.

Pennsylvania Housing Finance Agency has a program to assist homebuyers who are having difficulties due to circumstances beyond their control, but who do have reasonable prospects of resuming regular mortgage payments within 36 months.

- The affordable homeownership loans are secured by second mortgages and homebuyers do not have to start repaying them until the PHFA determines they are able to do so.

Fannie Mae and Freddie Mac emphasize the importance of default mitigation, making it common practice for affordable homeownership lending.

- Fannie Mae expects "servicers to attempt to resolve every delinquency by offering some type of loss mitigation alternative before they begin foreclosure proceedings."

- Freddie Mac emphasizes default mitigation with servicers by requiring that "loss mitigation must be an integral part of servicing operations."

Mortgage Guaranty Insurance Corporation (MGIC) and PMI Mortgage Insurance Company have developed similar alternatives for loan workouts to help homeowners avoid foreclosure. Among those options are:

- **Repayment plan** -- the homeowner agrees to bring delinquent payments up to date by adding extra amounts to the regular monthly payments or by delivering weekly or biweekly installments on the past-due amounts while making regular monthly payments.

- **Forbearance agreement** -- permits the homeowner to reduce or suspend monthly mortgage payments for a specified period of time and bring the loan current with a lump sum payment or repayment plan at the end of that time period.

- **Loan modification** -- changes the original terms of the loan, including interest rate reductions or capitalization of one or more delinquent payments for homeowners who need to reduce their monthly debt and can make modified payments.

In the event the homeowner cannot maintain monthly mortgage loan payments, and default is unavoidable, alternatives to foreclosure include:

- **Deed in lieu of foreclosure** -- homeowners may deed a property directly to the lender and be immediately released from any further liability from their debt. This "voluntary conveyance" is an option only when there are no subordinate liens against the home.

- **Presale** -- the "short sale" of the home, often for less than the total mortgage debt owed, may be the most cost-effective alternative to foreclosure because it releases homeowners from their mortgage debt while the lenders, investors and insurers avoid additional time and cost of recovering the revenue available from home sale proceeds.

CONCLUSION

Affordable homeownership lending can start a family toward the satisfaction of owning a home and the opportunity to build savings through homeownership.

Affordable homeownership lending programs can and do work effectively. They require careful management, beginning with homeownership education and counseling and ending with the origination and on-going servicing of the mortgage loan. This report has provided many successful, practical examples of how to expand affordable homeownership opportunities. An index to the examples is attached as an appendix to the report.

This report was based partially on discussions held at a series of forums co-sponsored by HUD, the Federal Housing Finance Board, and the Federal Home Loan Banks. A list of those organizations attending the forums is attached as an appendix.

The sponsors are grateful to the secondary mortgage market participants, the mortgage insurance companies, the mortgage banking firms, the banks and thrift institutions, the state housing finance agencies, and the community organizations for their participation and their commitment to affordable homeownership.

APPENDIX A
INDEX OF REPORT EXAMPLES

NAME OF ORGANIZATION	EXAMPLES
ACORN Housing Corporation	Homeownership Counseling
American Savings Bank, Stockton, CA	Understanding the Market
Atlanta Mortgage Consortium	Homeownership Education Affordable Homeownership Loan Products
Chase Manhattan Bank, New York, NY	Understanding the Market
Chattanooga Neighborhood Enterprises	Homeownership Education Enhanced Servicing Early Intervention
Center for Community Self-Help and Self-Help Credit Union, Durham, NC	Homeownership Counseling Prudent Underwriting Criteria
Countrywide Mortgage	Enhanced Servicing
Dupage Homeownership Center, Wheaton, IL	Homeownership Counseling Early Intervention
Fannie Mae	Affordable Homeownership Loan Products Prudent Underwriting Criteria Enhanced Servicing Default Mitigation
Federal Home Loan Banks	Flexibilty
Federal Housing Administration	Affordable Homeownership Loan Products
Freddie Mac	Affordable Homeownership Loan Products Prudent Underwriting Criteria Default Mitigation
GE Capital Mortgage Insurance Corp.	Homeownership Education Early Intervention
Guaranty Bank, Milwaukee, WI	Flexibility Understanding the Market Prudent Underwriting Criteria
Mortgage Guaranty Insurance Corporation	Flexibilty Affordabilty Homeownership Loan Products Early Intervention Default Mitigation
National Foundation for Consumer Credit	Early Intervention
Neighborhood Assistance Corporation of America	Partnering Default Mitigation
Neighborhood Reinvestment Corporation and Neighborhood Housing Services of America	Partnering Affordable Homeownersip Loan Products
Norwest Mortgage	Enhanced Servicing
Pennsylvania Housing Finance Agency	Default Mitigation
PMI Mortgage Insurance Company	Partnering

APPENDIX B

FORUM PARTICIPANTS

ACORN Housing Corporation, Philadelphia, PA
American Savings Bank, Stockton, CA
AmerUS Mortgage Corp., Des Moines, IA
AppalBanc, Berea, KY
Argo Federal Savings Bank, Summit, IL
Atlanta Mortgage Consortium
Center for Community Self-Help, Charlotte
Channel Link Capital Partners
Chase-Manhattan Bank, New York
Chattanooga Neighborhood Enterprises, Inc.
Citibank, Buffalo, NY
Citibank Mortgage, Inc., Stamford, CT
Citizens Savings Bank, Providence (Boston)
Center for Community Self-Help, Durham, NC
Countrywide Funding, Pasadena
Dime Savings Bank of New York, Uniondale, New York
DuPage Homeownership Center, Wheaton, IL
Equifax, Inc.
Fair, Isaac and Company
Fannie Mae
Fannie Mae Foundation
Federal Home Loan Bank of Boston
Federal Home Loan Bank of Chicago
Federal Housing Administration
Federal Housing Finance Board
Federal Reserve Board
Freddie Mac
GE Mortgage Insurance Company
Ginnie Mae
Guaranty Bank, Milwaukee
Housing Counseling Clearinghouse, Gaithersburg, MD
Maryland Housing Fund
Michigan State Housing Finance Agency
Mortgage Guaranty Insurance Corporation
National Association of Affordable Housing Lenders
National Community Reinvestment Coalition
National Foundation for Consumer Credit, Silver Spring, MD
Neighborhood Assistance Corporation of America, Boston, MA
Neighborhood Reinvestment Corporation
Norwest Mortgage (Des Moines) (Springfield, IL)
Office of the Comptroller of the Currency
Office of Federal Housing Enterprise Oversight
Pennsylvania Housing Finance Agency
PMI Mortgage Insurance Company
United Guaranty Corporation
Urban Institute
Wharton Real Estate Center
Woodstock Institute